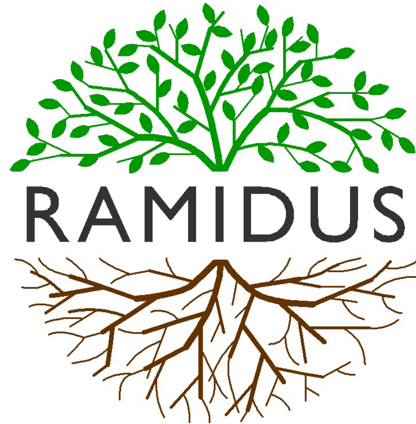


# The Business Rates Revaluation in London

The 2017 Business Rates Revaluation and its Impact on London's Micro, Small and Medium sized business community

# A report for

Experts in Business

GREATER LONDON REGION

# Supported by

GREATER LONDON AUTHORITY

CAMDEN TOWN UNLIMITED

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# Foreword

Business rates are a **property tax** that was used to fund local services formalised with the Poor Law nearly 500 years ago. However, far from the streets of London being 'paved with Gold' our high streets, and town centres are being blighted by this archaic tax on business that is regressive and preventing growth and jobs.

The facts are striking in that three quarters (74 per cent) of London businesses who responded to an FSB survey said that 'business rates' are the single biggest issue affecting their firms prior to the election.

The 2017 revaluation has led to swingeing rate increases that have led many of our respective members to ask themselves some fundamental business questions: Is it worth staying in the centre of London? Should I re-sign that business lease for another five years? Should I take on that extra member of staff? These are questions that we need to challenge and that policymakers at all levels must take extremely seriously if we are to prevent a dearth of small businesses operating in London. London is the UK's start-up capital and offers more for growing small businesses in terms of access to world-class talent, finance, and collaboration than any other city. What's more, the benefits of SME growth in London are felt far beyond the capital's borders. Likewise, if SMEs suffer in London, this too will be felt in other regions.

London is bearing a disproportionate share of the rating burden. The figures in the report show that while London has 16.2 per cent of rateable properties in the UK, it pays 32.1 per cent of the cumulative rates payable.

The 2010 revaluation added around £2.2bn in costs to London's businesses and the concern is this figure will significantly increase once taking into consideration the cumulative impact of the 2017 revaluation.

The Federation of Small Businesses and Camden Town Unlimited were keen to get a greater understanding of how the recent Rates revaluation has impacted small firms, so we are delighted to work collaboratively with the Mayor's Office and the London Economic Action Partnership (LEAP) to commission this report by Ramidus.

The Report provides the way for the Government to create a short, medium and long term approach to business rates policy that will back small business.

We want politicians of all persuasions to understand how the cost of doing business in the capital is blighting the opportunities for small firms and by adopting the calls for action in this report we can grow our record 1million+ strong businesses community in the capital to even greater numbers and help all businesses achieve their ambitions.

**Sue Terpilowski OBE**
Federation of Small Businesses
London Policy Chairman

Sue Terpilowski

**Simon Pitkeathley**
Camden Town Unlimited
Chief Executive

## Rents and rates

- London has 16.2 % of properties, but pays 32.1% of rates.
- England's rates have gone up by 9.6%, but London's by 23.7%.
- Hackney Industrial rates have gone up 100% on average.
- Retail rates in Hackney and Islington have gone up more the 40% on average.
- Central London, with just 0.2% of land, will generate more rates than the next 19 cities.

## Investments and jobs

## Profits and growth

# Executive Summary

**Context:** This report has been prepared by Ramidus Consulting for the Greater London Region of the Federation of Small Businesses (FSB) and Camden Town Unlimited (CTU), and funded by the Mayor of London and London Economic Action Partnership (LEAP), in order to examine the impact of the most recent rating revaluation on small- and medium-sized enterprises (SMEs) in London.

The most recent revaluation of the rating of commercial premises in England and Wales came into effect on 1 April 2017. This involves all properties being given a rateable value (RV) based largely on the rental values prevailing at April 2015, with business rates (rates) calculated by applying the Uniform Business Rate (UBR) multiplier.

The 2017 revaluation also raised the threshold at which small businesses begin to pay rates under the small business rate relief scheme: from premises with RVs of less than £6,000 to those of £12,000. In addition, the level below which the small business multiplier is applicable was revised from RVs of £25,500 in London and £18,000 in the rest of England to £51,000 nationally. The overall effect is that fewer properties are subject to rating, and more businesses will benefit from the small business multiplier across the country, but that is not necessarily the case in every local authority area.

While such a move was positive for many businesses across the UK, a major constraint is that the rates 'take', the total amount collected, is fixed. The impact is that if the Government wishes to cut rates for some businesses, it has to increase them for others. If rental growth is geographically varied, then this factor is amplified. Consequently, the impact on London and its small businesses will be disproportionate.

**Aggravating factors:** There are at least three aggravating factors that should be recognised when considering the rates burden on SMEs in London, First, there are Permitted Development Rights (PDR). Across London, in just three years, 1.62 million sq m of office space has been approved for conversion to residential use. The kind of property that small businesses like – inexpensive, adaptable and available on flexible terms – is what is being lost, and the combined impact of rising rates and rising rents, caused by reduced supply, is having a negative economic impact.

Second, there is technological change. On the one hand, this is transforming how many businesses operate, and, on the other, it is creating entirely new industries. The impact on the margins of retail businesses is particularly well understood. Further, technological innovation in business processes and workstyles means that growing numbers of firms are 'footloose'. And if costs mount, in the form of higher rents and business rates, then there is no reason why many should not move either to an online presence or out of London.

Third, there is Brexit, which is causing great uncertainty and, potentially, higher costs. Brexit has implications well beyond large firms and the financial services sector, and while large businesses have the resources to take measures to mitigate risk, London's SMEs do not.

**Impact of the rates revaluation:** According to Valuation Office Agency (VOA) data, London is bearing a disproportionate share of the rating burden. While it has 16.2% of rateable properties, it bears 32.1% of the rates payable. In itself, this is not controversial as it reflects relative rental values across England. However, rates are a one-size-fits-all tool and an implicit assumption is that all businesses operating in London are equally able to bear that burden: if they can afford rents then they can, by extension, afford the rates. However, this is not a reasonable assumption.

The Centre for Cities has estimated that the average rates bill will increase in just four city centres following the revaluation: London, Reading, Brighton and Oxford. Everywhere else they will fall on average. It also says that central London will contribute an even greater share of the overall rates bill: more than the next 19 largest English cities combined.

The vast majority of SMEs are tenants and for them rates are simply a bottom-line cost: they receive no investment value from occupying a building. The rates are not a tax on added value, or business value or income but a surcharge on expenses.

**The need for certainty:** Small businesses need certainty. While this is true of most enterprises, smaller ones are especially vulnerable to sudden financial changes. This is not unique to London, but London is a uniquely expensive place to do business. Any action that gives business greater certainty would be welcome.

Running a small business is challenging anywhere, but in some parts of London it is done in the context of very high property overheads. The rates, as currently structured, are blind to this geographical variation because of the need to keep the rates take constant: any attempt to address (say) economic stress in one location inherently forces stress in the form of higher rates bills onto another location.

We examined a number of case studies in order to provide real-life context to the broader data presented in this report. We do not claim that these case studies represent a statistically significant sample, but they highlight, with real evidence and experience, that small businesses have great difficulty in managing the impact of the rating revaluation. They also underline that real jobs and investment are being put at risk by a rating system that is entirely blind to the nature of the business in any given hereditament.

**A very complex system:** Businesses in London are subject to several levies, some of which are national and some specific to London: from the Community Infrastructure Levy to the Apprenticeship Levy and, in the past, supplements to fund the Elizabeth Line (Crossrail). Of course, sound cases can be made for all of these levies, and we would not suggest that they are, in any way, inherently ‘bad’. The key point is that business rates pre-empt these levies, with no scope for offsetting.

A critical factor that is masked by aggregate data is not that rates rise and fall, but that the system of exemptions and reliefs - including those announced in the recent Budget - push the burden of administration down the business hierarchy. This seems an undue burden on the enterprises that are least equipped to cope: small businesses, for whom the primary focus is cash flow.

**The threat to jobs:** When asked what the likely impact of the revaluation would be, only 15.7 per cent of FSB London[1] members said there would be no impact. Nearly one third stated that they would cut back on capital expenditure, while 20.1 per cent said they would reduce headcount.

Most concerning is that nearly a quarter stated they would look to shut their business, with another fifth saying they would look to move further from the centre of London, while 10.4% said they would move their business to home.

**Conclusions and recommendations:** On a larger scale, it is not unreasonable that the most prosperous areas should contribute more. But, even after netting out transitional relief, the 2010 revaluation added around £2.2 billion to London's business costs. There is no reason to believe that the new revaluation will have any less impact.

The research reported here has shown that the rates system in London is placing a very heavy burden on small businesses, threatening some with closure, preventing new investment in others and stifling growth in many. The following recommendations are directed at what the Government could do to create a system of rates that is more sensitive to, and better supports, the needs of London's SMEs.

### Short-term recommendations

Create a more sophisticated system of thresholds and reliefs to reflect higher values in London and avoid 'cliff-edge' changes in occupier liabilities. More-realistic thresholds need to be set and the value differential between Inner and Outer London needs to be properly reflected.

- Inner London: the threshold should be £20,000 RV for 100 per cent relief, tapering to £23,000.
- Outer London: here RVs have increased by a lower percentage, and the threshold for 100 per cent relief should be set at £15,000, tapering to £18,000.
- Review the new 'Check Challenge Appeal' (CCA) system, introduced in 2017, after its first year of operation to ensure that the system is operating fairly and efficiently and that small businesses are not being disadvantaged by the apparent complexity of the system because they are unable to afford independent advice.
- The Government should extend the local discretionary relief scheme announced in the March 2017 Budget and maintain levels of support in 2018/19 at the same level as 2017/18 – or at the very least confirm that local authorities will be allowed to reprofile their year-one funding to prevent many businesses from facing large, cliff-edge rises in future years.

### Medium-term recommendations

- The VOA should be adequately resourced in order to minimise mistakes in assessments and unresolved appeals, and to address the backlog of 250,000 appeals outstanding from the 2010 revaluation. It also needs to be made more accountable, in performance terms, to those affected by its decisions – local authorities and ratepayers. This should also extend to the Valuation Tribunal, which will be taking on responsibility for administering the final appeals stage of the new CCA system.
- We have said that the Government should shorten the two-year period required to prepare a revaluation.

- Revaluations should take place more frequently: at least as frequently as every three years, and ideally every two years. The Government is committed to looking at changing the frequency of revaluations but the next one is still scheduled for 2022, so the earliest the change might come in under current plans is 2025. Government should confirm its intentions on this as soon as possible and ideally bring the implementation deadline forward. This would help eliminate the need for the complex array of transitional reliefs, and provide SMEs with certainty.

**Long-term recommendations**

- There should be a major review of the entire non-domestic property taxation system. Over successive revaluation periods, the inflexibility of a centralised system has spawned an array of reliefs and remedies. This review could include looking at alternatives such as turnover taxes, land value taxes and valuation measures that take into account the shift away from property-based business operating models to online ones.
- It is time to revisit where responsibility for the setting and administration of rates resides. As part of this review, consideration could be given to the extent to which local taxation should be devolved, including the 100 per cent devolution model proposed by the Government in the Local Government Finance Bill and the London Finance Commission's more radical proposals for devolution of tax-setting powers (which have been strongly endorsed by the current and previous Mayor of London).
- The linking of business rates liabilities with the ability to pay lies at the heart of the matter. Rental values paid by ratepayers are not necessarily an equitable measure of ability to pay.

# 1.0 Introduction

The Government recently announced the latest rating revaluation of commercial premises in England and Wales, which came into effect on 1 April 2017. The previous revaluation took place in 2010, and they had occurred every five years since National Non-Domestic Rates (NNDR) replaced locally determined business rates in 1990. The revaluation process involves all properties being given a rateable value (based largely on the rental values prevailing at April 2015), with business rates calculated by applying the UBR multiplier.

The 2017 revaluation did two major things under one serious constraint. First was the revaluation itself, which calculated RVs according to the estimated rental values of properties at March 2015. Second, the threshold at which businesses begin to pay rates was lifted from premises with RVs of less than £6,000 to £12,000. In addition, the level at which the small business multiplier is applicable was revised from RVs of £18,000 to £51,000.

The Government also introduced a different transitional relief scheme with three new bands (small, medium and large properties) replacing the previous two bands (small and large). The cap on increases for larger properties – those with an RV of over £100,000 – was 42 per cent in the first year compared to only 12.5 per cent under the 2010 rating list. Owing to the impact of the revaluation, many SMEs in London were caught in the large property band and therefore faced 50 per cent rises in their bills on 1 April 2017, once other levies and supplements had been taken into account.

The overall effect of the changes in the small business rate relief and multiplier thresholds is that fewer properties will be subject to rating across England, and more businesses will benefit from the small business multiplier. However, the major constraint is that the rates 'take', the amount collected, is fixed. The impact of this is that if the Government wishes to cut rates for some businesses, it has to increase them for others. If rental growth is geographically varied, then this factor is amplified. The Government reduced the small and large business rates multipliers by 3.4 per cent to 46.6p and 47.9p respectively; after allowing for inflation, this reduction was lower than the 9 per cent average increase in RVs, primarily because of an allowance the Government applied for expected losses due to business rates appeals.

Owing to the differential increases in valuations, the impact on London and its small businesses will be disproportionate. The Centre for Cities notes that the average rates bill will increase in just four city centres: London (by 18.6%); Reading (7.1%); Brighton (6.4%) and Oxford (0.3%).[2] Everywhere else, they will fall. The same report notes that central London will contribute an even greater share of the overall business rates bill:

***In 2016/17, central London accounted for 17 per cent of all business rates generated in England and Wales. In 2017/18, this will rise to 21 per cent. The result is that this part of the country, which accounts for 0.02 per cent of land, will generate more business rates than the next 19 cities – including both their city centres and the wider city – put together.***

London is a very successful World City: it recently reaffirmed its number-one ranking in the Global Financial Centres Index.[3] It is also central to the UK economy, producing one fifth of the national output. It is a dynamic city, which has changed and adapted over time. This reflects the innovative and flexible nature of London businesses. For example, in 2016, London received more investment in its technology sector than any other city in Europe. It is therefore vital for the national economy that London continues to prosper, especially on the international stage. In this context, it is also critical to recognise the impact of additional costs, such as business rates rises, on its business community, and in particular on the bedrock of that community.

The popular image of London is, unsurprisingly, dominated by the large financial and professional firms and high-end retailers. But the oil that keeps the wheels of enterprise moving in London is found in its SMEs. The number of SMEs in London recently exceeded one million for the first time.[4] There are around 790,000 with no employees, and over 213,000 with between one and 49 employees (Figure 1). By contrast, and recognising that they employ large numbers of people, just 1,500 firms exceed 250 employees.

Of course, many micro businesses do not occupy commercial premises – often they are home-based. But once firms begin to employ people, or if they trade directly with the public (e.g. small retailers), then formal premises become more or less a prerequisite.

**Figure 1 Employee size structure of firms in London, 2016**
*Source: Dept for Bus, Energy & Industrial Strategy (2016)*

| Size band | London | |
|---|---|---|
| | Number | % |
| No employees | 791,000 | 78.2 |
| 1-9 | 180,800 | 17.9 |
| 10-49 | 32,500 | 3.2 |
| 50-249 | 5,700 | 0.6 |
| More than 250 | 1,500 | 0.2 |
| **Total** | **1,011,500** | **100** |

It is important to emphasise here that not all premises are occupied by small businesses. For example, when large foreign firms seek to establish a foothold in London they often take small units of space, and, even when established, their requirement here might remain relatively small. Figure 2 shows data for the Central Activities Zone (CAZ) from a recent report for the Greater London Authority (GLA), with occupied units broken down by size band.[5] The report suggested that around four fifths of occupied units cover less than 100 sq m (approximating to eight workstations).

**Figure 2 Estimated number of office occupations in CAZ, by size band, 2015**
*Source: Ramidus Consulting (2015)*

| Size band | No. of occupiers |
|---|---|
| <100 sq m | 79,417 |
| 101-500 sq m | 11,401 |
| 501-1,000 sq m | 3,343 |
| >1,000 sq m | 3,522 |
| More than 250 | 1,500 |
| **All office occupations** | **97,683** |

In addition to these office units, according to VOA data there are 89,000 retail hereditaments, many more than in any other region, ranging from prime West End shops to local parades. Again, the great majority are small firms of fewer than 10 employees.

It is a truism that London's SME base is, at an individual level, not as well equipped to deal with external shocks as large, corporate businesses, because they lack the resources of larger businesses. In this sense, the SME sector stands to be the most disrupted by the 2017 rating revaluation. The Government has sought protections for smaller businesses in the form of exemptions and reliefs, and these were added to in the March 2017 Budget – a £600 cap on the increase in bills year on year for five years for ratepayers losing eligibility for small business rate relief when these firms might otherwise have faced immediate rises of over £3,000, and a £300 million local discretionary relief scheme over four years administered and delivered by local authorities. London received around 41 per cent of the £300 million pot – but the allocation for 2017/18 of £72.5 million equated to less than one per cent of the £8 billion expected to be collected from London ratepayers. However, these aids and allowances are crudely drawn and seem to be based on a 'one-size-fits-all' approach that lacks sensitivity to the particular needs of London.

This report has been prepared by Ramidus Consulting for the Greater London Region of the FSB and Camden Town Unlimited, and funded by the Mayor of London and the London Economic Action Partnership, in order to examine the impact of the most recent rating revaluation on SMEs in London. The work has involved an analysis of published statistics and stakeholder feedback. The report begins at the most general level, exploring the context in which modern London businesses operate, and then narrows down to consider some detailed impacts, before drawing conclusions and making recommendations for how business rates can be made fairer and how SMEs adversely affected by the revaluation can be better supported.

# 2.0 Context: age of uncertainty

Over and above the recent rating revaluation, SMEs in London are already facing a number of challenges. We highlight three here because it is vital to understand the context in which the rating revaluation has taken place. The three particular pressures are: Permitted Development Rights, technological change, and Brexit.

## 2.1 The known known: Permitted Development Rights

While office-to-residential conversion is not a new phenomenon (significant losses to non-office use have been occurring for over 20 years), the Government's extension of PDR in 2013 has changed the landscape, bringing housing land and employment land into much more direct competition – with major consequences for small businesses reliant upon secondary, economical space.

The impact of office-to-residential change has not been uniform and property market verities remain a significant factor: it should be no surprise that the bulk of the pressure has been felt in the North West, West and South West of London – some of the most affluent locales in the capital. Between 2013 and 2015, Croydon and Brent each saw around 180,000 sq m of office-to-residential approvals; Camden, Harrow, Hounslow, Richmond, Sutton and Tower Hamlets all saw 80,000–90,000 sq m of approvals; while Greenwich, Hackney, Haringey, Havering, Southwark and Westminster all saw less than 10,000 sq m.

There is little doubt that PDR has helped to clear much obsolete office stock, but it is equally plain that a planning tool which is blind to the role of property values in shaping private- sector decisions can have unintended consequences. Good space is lost too – not necessarily Grade A, but serving the needs of cost-conscious SMEs. In some London boroughs, well over half of PDR schemes have involved occupied buildings.

Across London, in just three years, 1.62 million sq m of office space has been approved for conversion to residential use. Almost one third of converted buildings have been at least partially occupied – a number that underestimates the impact by excluding buildings where owners emptied buildings before a prior approval, or chose not to re-let vacant space that might have found a willing tenant. We estimate that around 50,000 jobs have been disrupted, with the overwhelming majority of these being in SMEs occupying economically priced space.

Nor is this problem limited to office space. Inner London has lost over a third of its stock of industrial premises, largely under pressure from residential. This is the kind of property small businesses like: inexpensive, adaptable and available on flexible terms. Indeed, much of this 'industrial' stock is, in fact, occupied by a plethora of service-based businesses involved in 'clean' activities that provide the expanding central London business market, and the wider London economy, with a huge array of goods and services.

Moreover, as commercial supply decreases, so prices for what remains increase. We know that rental values have more than doubled for secondary space in many of what were formerly dubbed 'fringe locations' on the edge of traditional core areas. Thus SMEs are suffering from the double whammy of reduced supply of appropriate space and an increased rent burden for what remains. Combined with rising business rates, occupancy costs are rising faster than the volumes and prices of goods and services sold. Even with business numbers increasing, this means that some locales could become unsustainable as strong SME centres.

## 2.2 The known unknown: technological change

Technological change is, on the one hand, transforming how many businesses operate, and, on the other, creating entirely new industries. The emergence of Tech City is emblematic of the fact that entirely new types of business have evolved over the past two decades – it is probably not recorded when the first web design agency was set up, but it can only possibly have been after 1996; other businesses, such as printing and graphic design, have been revolutionised. A report by Oxford Economics[6] underlined the role of the internet as a shared platform, with mobility, cloud computing, business intelligence and social media being key ingredients.

Indeed, the digital economy is transforming business structures. The UK and London's so-called 'gig economy' of small businesses (which in fact includes a host of businesses, some of which are tech businesses but many of which are in accounting, design, engineering, finance, law, management consultancy, media and real estate) is being driven, at least in part, by the ubiquity of technological change.

The emergence of fintech and the application of machine learning to business problems is a very good example of these trends. More widely, it is acknowledged that London is the tech capital of Europe. It has a hugely successful agglomeration of businesses, most very small. London-based SMEs in the Information & Communications sector alone employ 93,000 people, with 73,000 sole-proprietor businesses or businesses with no employees. These firms account for a turnover of £17 billion, equivalent to 24 per cent of the sector's total.[7]

However, technological innovation in business processes and workstyles means that growing numbers of firms are footloose. And if cost pressures mount, in the form of higher rents and business rates, then there is no reason why many should not migrate – either to an online presence or out of London. Higher business rates therefore pose a particular threat to businesses that could leave London.

Technology has had a particularly sharp effect on retail. Twenty years ago, the primary threat to high streets was out-of-town retail. Now it is the internet. While London's retailers have been on the receiving end of some of the biggest uplifts in RV, online retailers, which range from very large, global operations to small specialists trading out of self-storage units, have not been as hard hit, if they pay at all. The shift to online retail is a profound structural change to which the business rates system has, arguably, been wholly blind.

## 2.3 The unknown unknown: Brexit

There remains a great deal of uncertainty over the nature of the UK's withdrawal from the European Union (EU) – in respect of both process and impact. Perhaps unsurprisingly, the Brexit debate in London focused on the potential loss of jobs in large financial firms in the City and Canary Wharf, but Brexit has implications well beyond large firms and the financial services sector. And while large businesses have the resources to take measures to mitigate risk, London's SMEs do not, and they find themselves operating in an environment of great uncertainty.

So far, despite some dire predictions, there has been little direct impact: the stock market recovered quickly, and the FTSE 100 has since broken 7,500. By contrast, sterling's fall has been sustained. Business confidence surveys generally fell after the referendum, but showed distinct recovery from August onwards, and we have not witnessed anything like the existential crisis that gripped the economy during the 2008 Credit Crisis. Nevertheless, we are entering a period of uncertainty that could have a negative impact on the property market over the medium term.

Now that negotiations are well under way, indicators could take a more bearish turn. For a prolonged period, market uncertainty will prevail with a constant 'drip-drip' of so-called news about the negotiations. The overall impact might be to heighten caution and severely dampen activity. Again, SMEs are the least able to influence events and least able to take mitigating action, other than to cut costs.

Perhaps the greatest threat to London-based financial jobs is the prospect that the UK will lose its 'financial services passporting' rights, and it is important to note that much of London's emerging micro and SME fintech sector is built on a vibrant financial sector.

One of the many points that remains unclear at this stage is whether or not there will be a gradual transition out of the single market, or whether there will be a clean and abrupt break in current trade agreements. Obviously, the former would allow for a period of adjustment, and would be likely to calm nerves, but again an abrupt break would hit SMEs hardest.

For balance, it is worth noting that other European countries face challenges and London's long-standing role as a 'safe haven' for business should not be underestimated. Further, central London is a classic economic cluster, in which strong supply-chain relationships reinforce the benefits of agglomeration

It is perfectly possible that the UK economy and London, in the longer term, continue to operate in the relatively normal way that has prevailed since 24 June 2016 (especially with a five-year transition period). However, this will be strongly influenced by the quality and nature of the news that emerges during exit negotiations. It could, equally, be characterised by prolonged uncertainty. For business-to-business SMEs especially, this uncertainty is far from welcome.

If the perceived prospects for Brexit worsen – from a UK perspective – then rising London costs (rent and rates), combined with technology that loosens locational ties, could begin to create a set of conditions in which SMEs begin to reconsider their commitment to London.

Any adverse impacts of Brexit will not lead to a reduction in rates payable until after the next revaluation in 2022, and five years is a long time for any business. The revaluation system could therefore be more responsive to shorter-term economic changes.

# 3.0 Impact of the rates revaluation

When considering the impact of changes to business rates, a series of questions need to be investigated (although the lack of readily accessible small area data on SMEs can make this challenging). What are the key impacts for SMEs in London compared to the regions? How will different boroughs be affected? How are different sectors and locations affected?

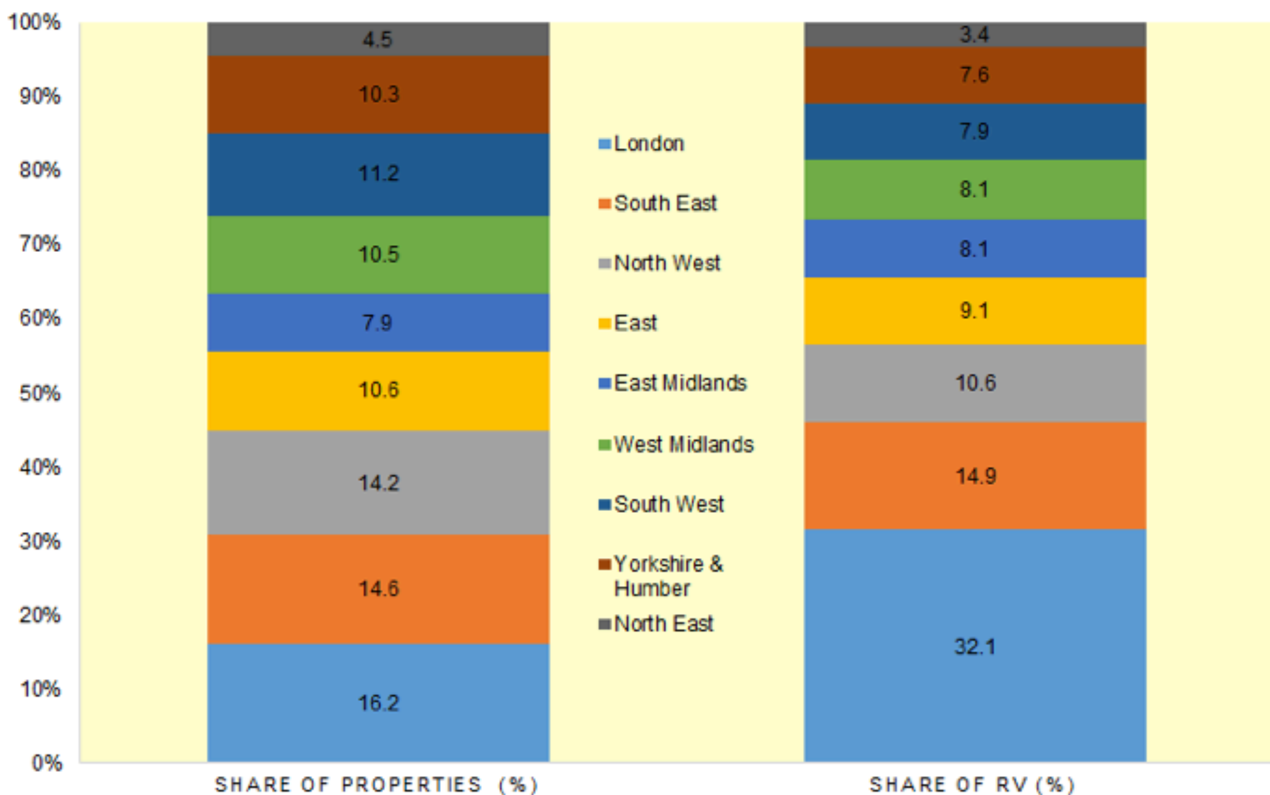
## 3.1 London compared to the regions

According to VOA data,[8] London bears a disproportionate share of the rates burden relative to the number of properties it has. While it has 16.2 per cent of rateable properties, it yields 32.1 per cent of the rates payable (Figure 3). In itself, this is not controversial – London has consistently been the most economically successful UK region, and might be expected to pay a higher share. However, business rates are a one-size-fits-all tool and an implicit assumption is that all London businesses are equally able to bear that burden: if they can afford rents then they can, by extension, afford the rates.

This is not a reasonable assumption, however. The vast majority of SMEs are tenants, for whom rates are simply a bottom-line cost: they obtain no investment value from occupying a building. Rates are not a tax on added value, business value or income, but a surcharge on expenses.

**Figure 3 Number of properties versus share of rating burden**

*Source: Valuation Office Agency (2017)*



The net result of this weighting is that London bears a disproportionate burden in RV terms in every sector of commercial space (Figure 4). No other region has any sector with increases of more than 20 per cent, while in London three out of four sectors see increases of more than 20 per cent – only industrial space is lower, at 15.5 per cent. The reason for this pattern is that the Government has tried to reduce the rates burden in areas under stress, while maintaining the overall rates take. As noted above, this means that reducing the take in one area leads to increasing it elsewhere – with London the primary source of increase.

**Figure 4 Change in RV from 2010 rating list to 2017 revaluation**
*Source: Valuation Office Agency (2017)*

| Region | Retail | Industry | Office | Other | All |
|---|---|---|---|---|---|
| London | 26.8 | 15.5 | 22.6 | 26.1 | 23.7 |
| England | 4.8 | 4.0 | 12.7 | 15.9 | 9.6 |
| South East | 1.2 | 6.7 | 12.9 | 17.8 | 9.6 |
| East Midlands | 5.6 | 3.3 | 8.2 | 13.4 | 7.4 |
| South West | **(5.7)** | 5.4 | **(0.4)** | 13.9 | 4.0 |
| West Midlands | **(0.9)** | 3.4 | **(6.8)** | 12.3 | 3.7 |
| East Midlands | **(3.6)** | 2.3 | 2.4 | 12.3 | 3.7 |
| North West | (5.4) | **(3.5)** | **(4.4)** | 10.7 | 0.0 |
| Yorkshire & Humber | **(1.9)** | 0.7 | **(12.4)** | 7.1 | 0.0 |
| North East | **(6.5)** | **(0.4)** | **(12.3)** | 9.5 | **(0.9)** |
| Wales | **(8.5)** | **(4.0)** | **(6.6)** | 4.5 | **(2.9)** |

A reasonable case can be made that the rates system is no longer fit for purpose. Although the 1988 reforms to rates set a national rate multiplier, the underlying principle is unchanged from earlier systems, and appears to rest on the philosophy that expensive space is occupied by firms with the ability to pay. This may seem reasonable, but for every highly profitable boutique hedge fund manager there are dozens of enterprises undertaking lower-margin activities. Further, prosperous businesses outside London and the South East may see their rates bills fall as struggling businesses in London see them rise.

Small businesses need certainty. While this is true of most enterprises, small businesses are especially vulnerable to sudden financial changes. This is not unique to London, but London is a uniquely expensive place to do business. Any action that can give business greater certainty, or at least fewer abrupt changes, would be welcome. The RPI cap is intended to do this, but is swamped in some areas by high growth in RVs.

## 3.2 Variation between London boroughs

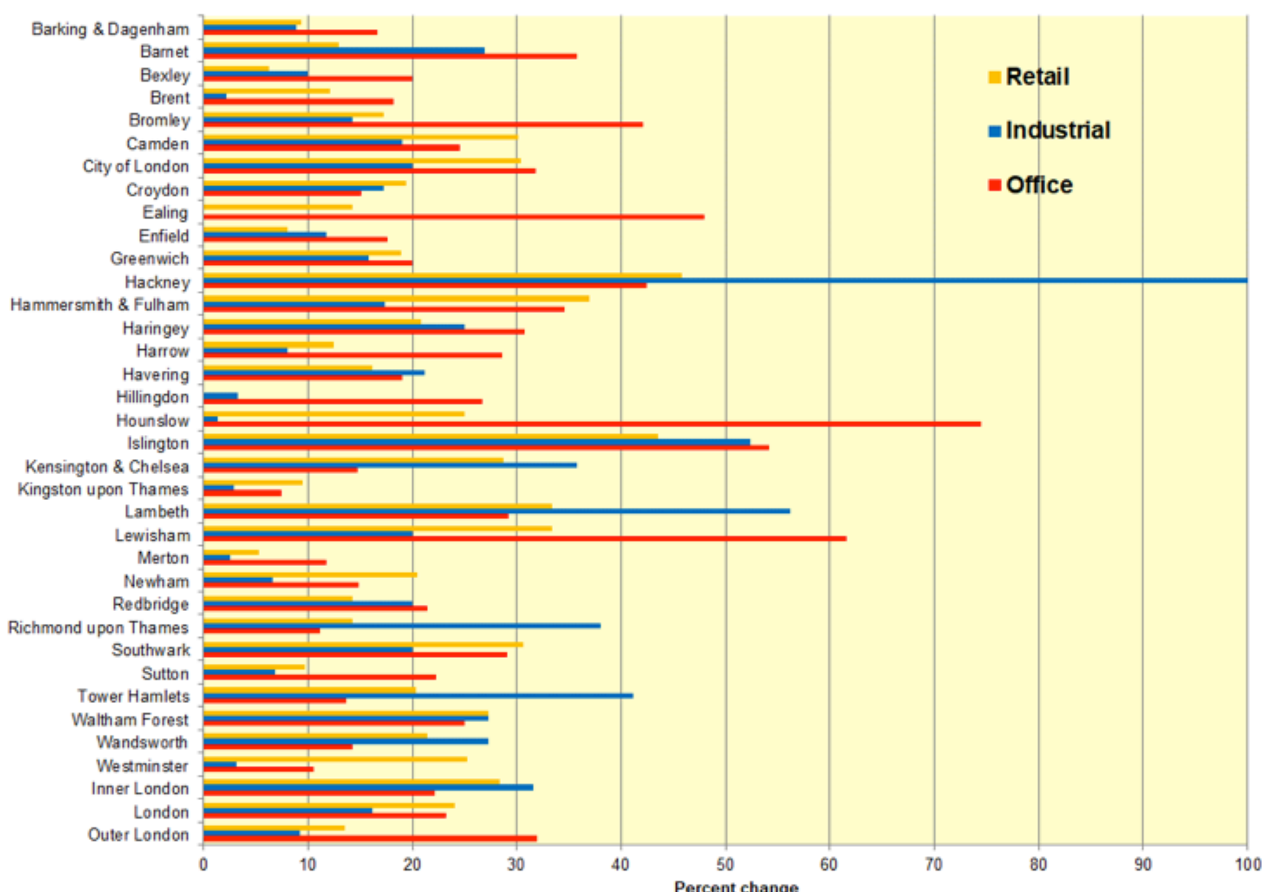
Regional data hide a great deal of variation of impact at the local level. Figure 5 shows the average change in RV per property, between 2010 and 2017, for London boroughs and the major sectors, ranked in terms of the industrial increase. Office and industrial properties saw the largest increases in some areas but all sectors saw across-the-board increases.

Even though some of these increases should be no surprise, the crude nature of the rates system is somewhat exposed. For example, when valuations for the 2010 revaluation were set in 2008, Hounslow had not seen the development of new phases at Chiswick Park. One must be cautious about drawing inferences from aggregated data, but it is striking that, for example, Hackney has seen industrial average RVs rise 100 per cent when, since 2000, it has lost 50 per cent of its industrial stock. Indeed, all Inner London boroughs have seen sharp rises, possibly driven by the emergence of new technology clusters, especially north of the City of London and south of the South Bank.

Similarly, Inner London retail properties have seen the highest average increases, and it seems likely that in Hackney and Islington, sites of the two greatest increases, change is being driven by the emergence of Tech City, as newcomers generate enough spend to drive up retail values.

**Figure 5 Change in average RV, by borough and sector, 2010-2017**

*Source: VOA data, Ramidus Consulting[9] (2017)*



## 3.3 The impact in different sectors and locations

While London on the whole is a very successful city, and a level of disparity is to be expected with other cities and regions, small businesses face the same concerns as in other areas, with close attention to cash flow and cost control. It is fallacious to assume that because a business is in London, it is better able to pay higher occupancy costs. However, the most recent rating revaluation has had a disproportionate impact on London. This is especially evident in the office sector, but is clear across all major property sectors.

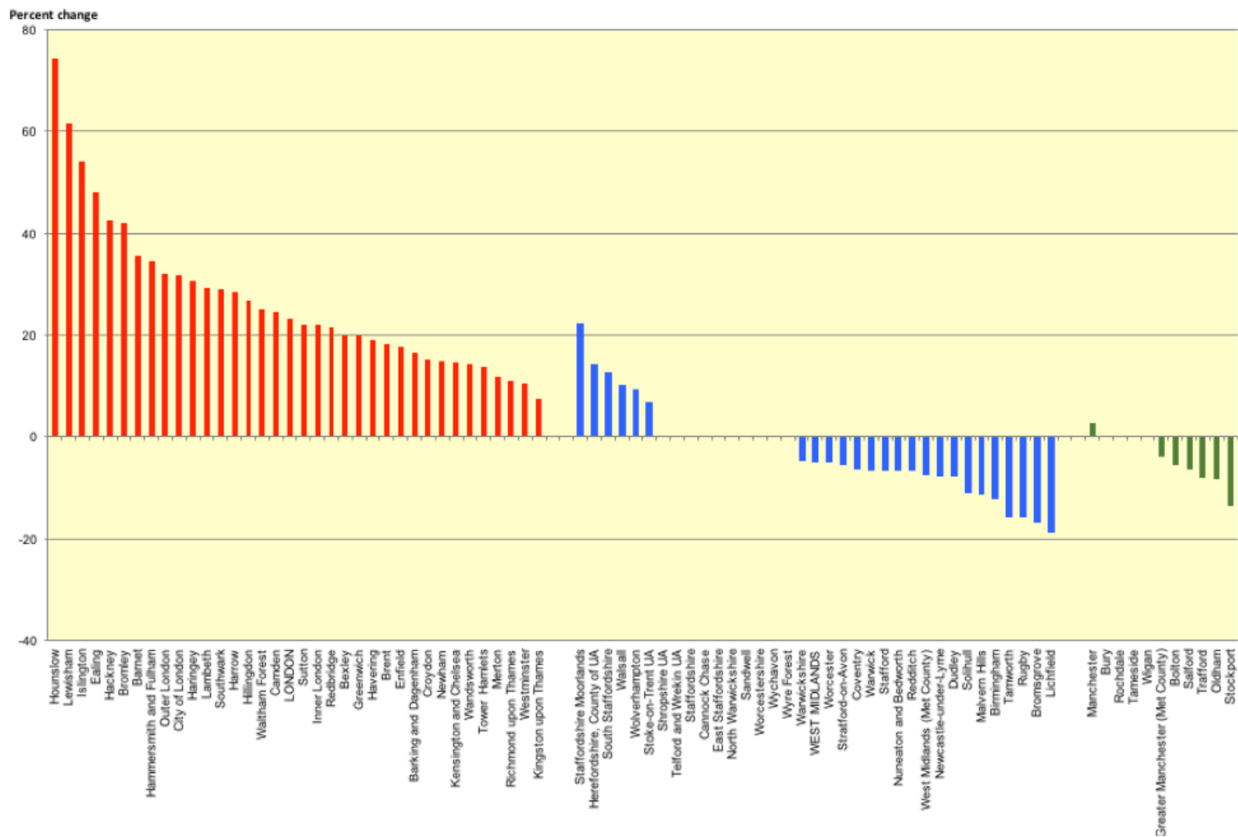
Figures 6 to 8 illustrate this point by comparing RV increases between 2010 and 2016 in London, the West Midlands and Greater Manchester.

**Figure 6, Office:** The office data are particularly troubling not only because small and micro businesses make up around one fifth of the office market, but because this sector provides the services that 'oil the wheels' of central London's economy and its huge contribution to the national economy.

**Figure 7, Retail:** It is perhaps surprising to see Newham's RV rising less sharply since 2010 than other areas, given the opening of the Westfield shopping mall. It seems likely that its presence, and its impact on trading patterns, has not yet fully worked through. Substantial rises in RVs are likely to occur in future revaluations. The cumulative effect, again, is that London has incurred a disproportionate increase.  Eighteen London boroughs see average increases of over 20 per cent, compared with one in the West Midlands and none in Manchester.

**Figure 8, Industrial:** For industrial occupiers there is a particular problem: rate increases are coming in after a period when London as a whole, and Inner London especially, has been losing stock: since 2000, Inner London has lost over one third of its industrial stock, largely under pressure from residential use. Hackney and Westminster have both lost half of their stock since 2000.

## Figure 6 Percentage change by local authority, 2010-17, average RV, office




## Figure 7 Percentage change by local authority, 2010-17, average RV, industrial

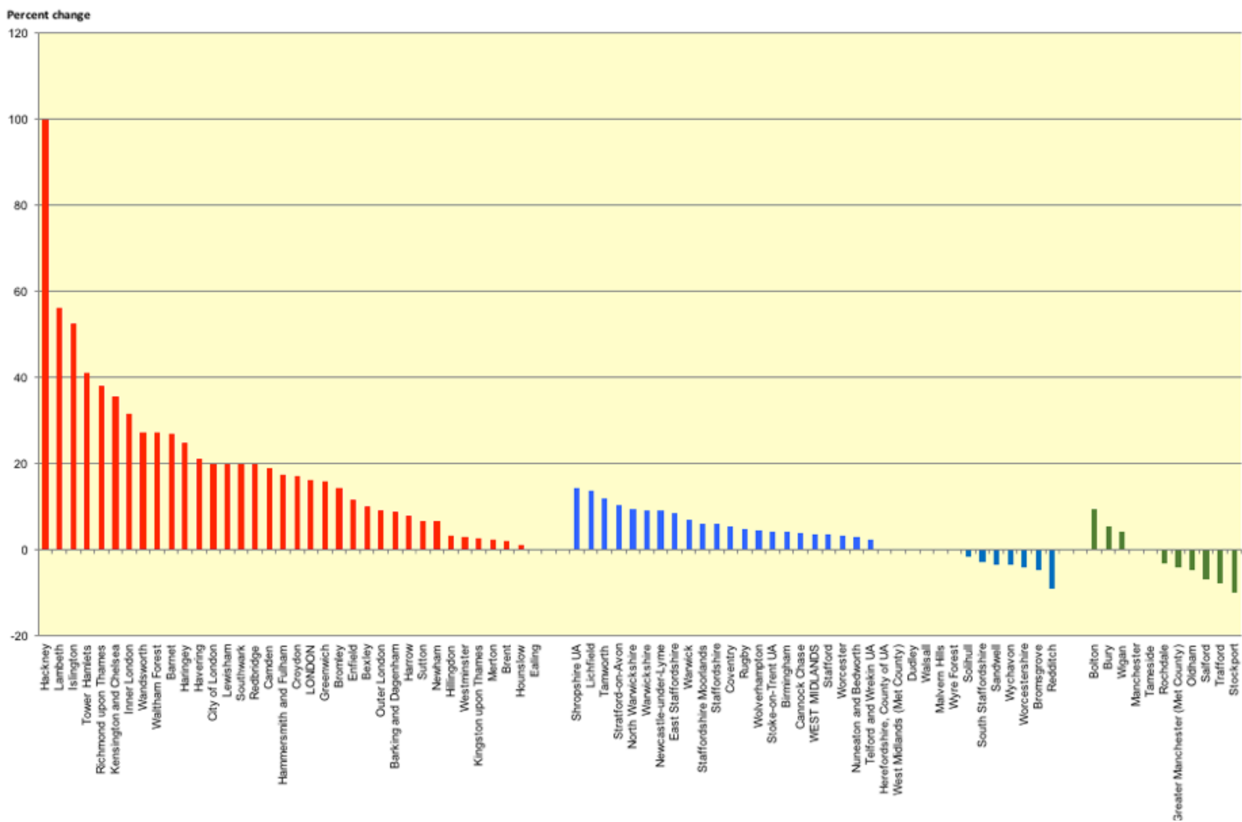


**Figure 8 Percentage change by local authority, 2010-17, average RV, retail**

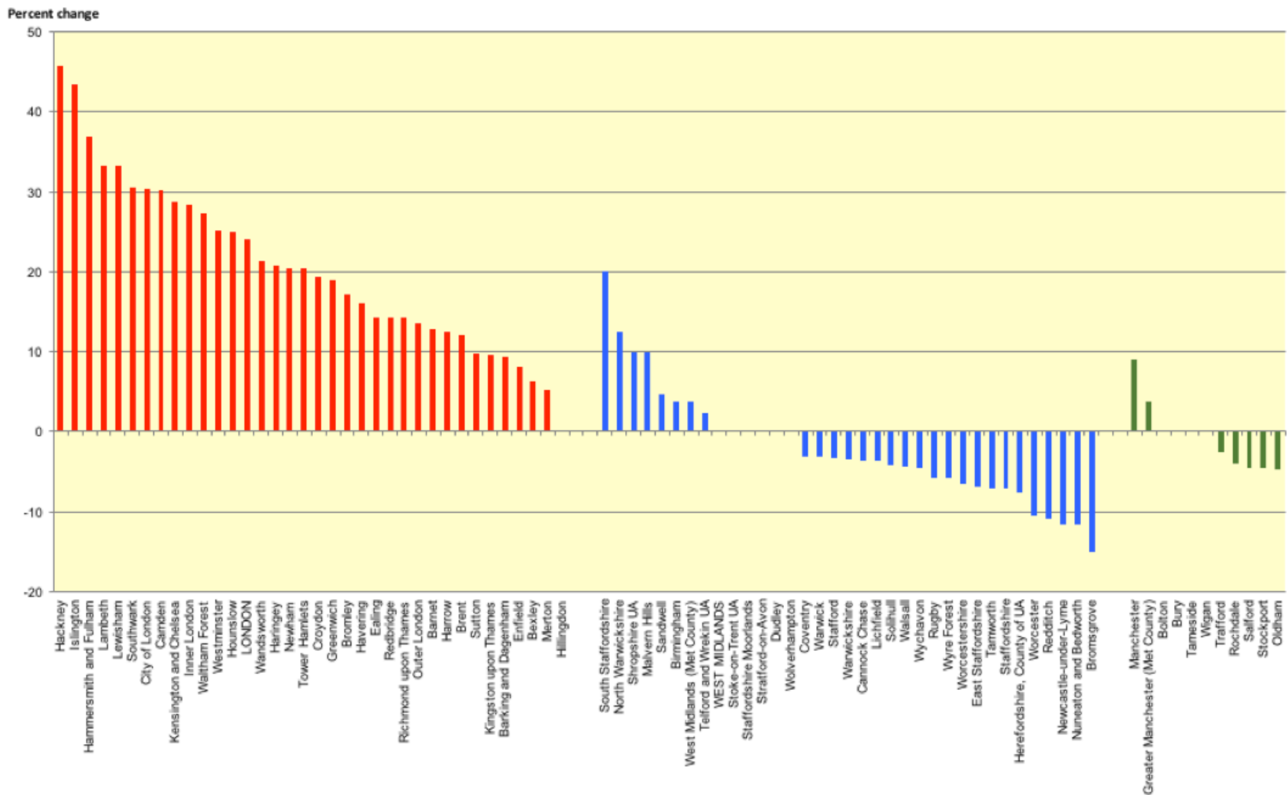



Figure 9 summarises the RV changes between 2010 and 2017, across the three regions. It is clear that London is, indeed, disproportionately affected by the revaluation and that, even with regard to offices and industrial properties, the difference is far from trivial.

**Figure 9 Rateable value average change 2010-17, summary**

*Source: VOA data, Ramidus Consulting*

| Region | Retail | Industry | Office |
|---|---|---|---|
| London | 23.2 | 16.1 | 24.1 |
| Greater Manchester | -4.0 | -4.2 | 0.0 |
| West Midlands | -4.8 | 3.6 | 3.8 |

With regard specifically to Central London, Centre for Cities[10] found that, in 2016-17, central London:

***accounted for 17 per cent of all business rates generated in England and Wales. In 2017/18, this will rise to 21 per cent. The result is that this part of the country, which accounts for 0.02 per cent of land, will generate more business rates than the next 19 cities.***

In fact, Centre for Cities found that only two cities had an average increase in rates bills, London and Reading (Figure 10). As noted earlier, only four city centres see increases.

**Figure 10 Average increase in business rates in cities after revaluation**
*Source: VOA, cited in: Centre for Cities (2017)*

| City | Change in average rates bill, 2016-2017 to 2017-2018 (%) | Average workplace wages 2016 (£/week) |
|---|---|---|
| London | 8.7 | 697 |
| Reading | 6.3 | 634 |
| Cambridge | -2.0 | 603 |
| Slough | -2.4 | 588 |
| Brighton | -2.5 | 471 |
| Oxford | -4.3 | 576 |
| Milton Keynes | -5.3 | 626 |
| Crawley | -6.6 | 634 |
| Aldershot | -8.7 | 566 |
| Bristol | -10.3 | 525 |

*Centre for Cities also found that large businesses will contribute much more:*

***Where properties have a rateable value over £70,000 in 2017/18, the average business rates bill will rise by 7 per cent.***

***This increase is again mainly limited to the Greater South East. The average business rates bill for large properties will increase in just 12 cities, nine of which are London or its neighbours.***

We see no reason to dispute this finding, but the problem with such generalised data is that they mask a great deal of variation in the real-world impact of revaluation. For example, although all of London is an expensive place to do business, some areas are much more expensive than others. Running a small business is challenging anywhere, but in some parts of London it is done in the context of very high property overheads. The rates, as currently structured, are blind to this geographical variation because of the need to keep the rates take constant: any attempt to address (say) economic stress in one location inherently forces stress in the form of higher rates bills onto another location.

# 4.0 Case studies

This section provides six small case studies to illustrate some of the themes emerging from the data. These case studies cover five sectors to illustrate the widespread issues resulting from the revaluation: retail (x2), office, light manufacturing, light industrial, and food service.

## 4.1 Case study #1: Retail

This business is a retailer in a parade of shops in central London, near Cambridge Circus. There are six stores in the parade, originally built by the GLC and acquired from the London Residuary Body by the occupiers in the late 1980s. The business has been in situ for 30 years. In addition to the proprietor, there are two staff and occasional help from two others, including the proprietor's partner. The owner says:

***Our Armageddon was actually the 2010 revaluation, when our valuation went from £21,000 to £53,000.***

There are two elements to the challenges faced by this retailer. First, in a parade of six shops, five were paying around £30,000 per year in rent while one was paying £50,000, on a short lease. This suggests that the VOA was taking top rents as the basis for valuations, rather than average rents, and, further, adding a slight premium. This was described as a ***'tax on an arbitrary valuation***'.

Secondly, adding to the financial burden was the experience of the appeals procedure. Several units appealed using no-win, no-fee agents who gave up at the initial rejection of the appeal. The proprietor decided to handle his own appeal.

Because he had no previous experience of such tribunals, he decided to attend several to find out how they worked, and noted that it is very common indeed for case officers to be absent and cases to be handled by a substitute who typically presents the file and says they cannot comment further as it is not their case. This duly happened at his own tribunal, leaving him to challenge without being able to question the case officer.

***I was shocked by the valuation office attitude. In a block with five shops at £30,000 and one at £50,000, the VO was determined to take the top rent as the valuation. To go to that extent to defend a theoretical valuation makes you question their motives.***

In the end, this shop owner was able to reduce his valuation to £43,000 and the 2017 revaluation has increased this to £50,000.

***It is not even our own landlord. The one across the road can get a high rent and we get the increase (in rates). The ultimate result is that I will cut back on staff. A lot of people have gone online-only.***

Transitional arrangements, which seek to take some of the sting out of rates rises, are 'of no use', according to this business owner:

***It is too small and delays for only a year. It doesn't solve the problem.***

The issue of the bureaucratic nature of the appeals process is echoed elsewhere. In the response of the British Retail Consortium to the March 2017 Budget, Chief Executive Helen Dickinson said:

***We hope that the relief measures will help some of those businesses hardest hit by the revaluation, albeit only temporarily. However, more short-term relief measures continue to add complexity to an already impenetrable system. £435 million is a drop in the ocean compared with the £25 billion a year that the tax raises. This is yet another sticking plaster on a chronically ill patient – an unsustainable property tax higher than anywhere in the developed world.***

Further, the 2017 revaluation introduced an important revision to the appeals process – the Check, Challenge, Appeal system. Although intended to simplify and clarify the process, it is far from clear that this change will achieve that goal.

This case study illustrates the bureaucratic nature of the appeals system, which seems blind to the day-to-day challenges of running a small enterprise. But it also shows that concerns about high rates are far from a new phenomenon.

## 4.2 Case study #2: Retail

Another retailer, this time located in the East End, near Spitalfields close to the City of London, has seen the structural change in its local area drive values up – with the inevitable rate rises following:

***In 18 years of running a business and a shop, I've never seen such a steep rise in an overhead. We have watched the area redevelop over the last decade and the value of property rise beyond comprehension. Despite this, businesses have seen their turnover and salaries stagnate. The market is a fragile place and whether you're selling handmade jewellery, fixing cars or distributing groceries, there is only so much you can put your prices up before the consumers will simply not buy the product. We recently relocated our London studio to Kent as property prices meant manufacturing in London became unviable. This hasn't just happened to us, it's happening all over London, and where space used to be accessible and an enabler of businesses, it is now a luxury.***[11]

This then creates a problem when rates are assessed according to the buildings' rental value:

***The fact business rates are calculated on the value of the property they operate from adds insult to injury. We have seen no benefit from the rise in value of our shop on Brick Lane; the rising property prices have forced many local customers out of the area, leaving us with tourists who come to visit the hyped-up and much-celebrated area but don't necessarily spend money. Rates need a fair system which relates more to a business's turnover or profits, but not as a reflection of your landlord's assets.***

Transitional relief, although welcome, is not a proper fix, according to Krissie Nicolson of the East London Trades Guild:

***Transitional relief is welcomed although in many ways it just delays the inevitable. Unless we see serious improvements in the economy, businesses may see no growth in turnover over the next five years and yet we will still be faced with having to find an extra £1,000 a month with no added benefits. This amount of money could literally mean the end for many businesses and it will break my heart if I see any more shops close owing to spiralling costs.***

Although retail is perhaps the most visible sector as regards media coverage of business rates – because a much-loved independent store closing is invariably newsworthy[12] – sharp increases are by no means limited to that sector, and the impact is no less challenging.

This case study emphasises that the occupier of a property is not the party that benefits from the value of the property and that rates are surcharging a party that does not benefit from the capital growth of property.

## 4.3 Case study #3: Office

A public relations firm based in London Docklands with 10 staff, which was a new occupancy in 2015. The change to the valuation is outlined in Figure 11.

**Figure 11 Docklands office, impact of revaluation.**

| | 2016/17 | 2017/18 | Change % |
|---|---|---|---|
| Rateable value | £10,000.00 | £22,000.00 | 120.00 |
| Multiplier | 48.4 | 46.6 | |
| Base bill | £4,840.00 | £10,252.00 | |
| Small Business Rates Relief (SBRR) | £1,613.34 | | |
| Transitional adjustment | | £5,068.36 | |
| Final bill | £3,226.66 | £5,183.64 | 60.65 |

A more than 100 per cent increase in RV for an occupancy that has only been in place for three years is striking. When worked through, the liability for this business is still more than 60 per cent higher than before the revaluation, even after transitional relief, and it is not yet clear when or if any of the extra relief announced in the 2017 Budget will help. As transitional relief works through the increase means, in the words of the proprietor: ***"… We have completely come out of SBRR now and have to find a massive amount more money."***

This case study has two dimensions. The property referred to here is well over 20 years old and was part of the first wave of Docklands schemes. Such properties are by no means modern and yet this is a very sharp RV increase. Second, the accompanying steep increase results in this business no longer receiving SBRR and presents a step change in bills that any business would find onerous.

## 4.4 Case study #4: Light manufacturing

A small manufacturer in Hackney reports a rate increase of 150 per cent:

***We are looking at nearly a 150 per cent increase from current rates over the next three years, £60,000 to £156,000. Some of the highest in the country. In monetary terms, currently £31,020 will increase to £44,000 from April 2017, then £66,000, and then £74,000 in the following years. The danger is, with this sort of money, we're talking nearly the equivalent to two people's jobs.***

Concluding that:

***The current property situation is forcing businesses and people out of London who would otherwise provide diverse employment and homes for all sorts of people.***

Adding:

***The increases in RV will inevitably make us reconsider whether Hackney is a viable location to continue a light manufacturing business or even consider if the business itself is worth continuing given the pressures of space and rent. With 1/3 of the workforce coming from local boroughs, this would have an effect on their continued employment – the ability to take on trainees as well as the compounding consequences for local suppliers if we were to move elsewhere.***

This case study illustrates that businesses are having to contemplate hard decisions about whether they can continue to trade in given locales, and that this is not limited to retail.

## 4.5 Case study #5: Light industrial

Another light industrial business, a Haggerston-based car repair firm, said:

***This has gone way, way over the top. I am so stressed because I see no hope for the business. Ministers should come down to ground level to see what businesses like ours do for our local communities.***

The business works with a local charity to provide job opportunities and mentoring for young people. Its RV has increased by £10,000.

This case study illustrates not only the personal impact of sharp rates increases but also the potential impact on how small businesses can engage with their communities. The jobs and opportunities offered by this business are being put at risk by increased overheads.

## 4.6 Case study #6: Food service

One of the last surviving small, independent food shops in Spitalfields, occupying a popular tourist photo-spot, has seen its RV increase from £13,250 to £33,000. The 1780s building on Brushfield Street E1 has been home in the past to diamond-cutters, furriers, bootmakers, drapers, bookbinders and a refugee who ran a French millinery business. The proprietor said:

***Despite paying a huge rent, and against all odds, I have managed to survive providing the same honest, friendly service to the local community, providing jobs and promoting the work of small producers, the likes of local beekeepers, artisan bakers, small brewers, etc. We all work extremely hard. It's a labour of love that won't make me rich, but wouldn't we all lose a great deal if we had to close down?***

Adding:

***Wouldn't it be heartbreaking to see a place with so much history in the local community turn into another branch of Costa Coffee or a Prêt-à-Manger? Although a Chanel shop or big food chains might bring lots of very much appreciated revenue to this borough, it's family businesses … that keep the soul and integrity of old Spitalfields alive.***

This case study strongly illustrates how existing business can be hit by development nearby. This is in no way a suggestion that development is bad, but that it has entirely foreseeable consequences that any increases in rates can magnify.

## 4.7 Case study overview

We do not claim that these case studies represent a statistically significant sample of all businesses, nor do we deny that there are businesses that have benefited from the revaluation. But the case studies do highlight, with real evidence and experience, that small businesses have great difficulty in managing the impact of the rating revaluation. They also underline that real jobs are being put at risk by a rating system that is entirely blind to the nature of the business in any given hereditament.

Notions of 'soul' and 'integrity' as well as the engagement of businesses with their local communities are not easily captured in valuation calculations. But these are often the businesses at the heart of 'placemaking' and, in effect, surcharging their business expenses directly hampers this.

As noted in some of the case studies above, the rates system imposes costs that can limit growth for small business. This, in turn, undercuts wider urban development initiatives. Simon Pitkeathley, Chief Executive of Camden Town Unlimited, the Business Improvement District (BID) for Camden, sees ***"lack of workspace at the affordable end in well-connected areas", adding that "the system as set up is not an efficient market".***

If landlords are not fulfilling market needs (and poorly thought through PDR schemes actively disincentive this), then

***From a place-making perspective, it is the landowners who are the concrete ceiling.***

He suggests that applying rates to the owners may ***"force them into the light."***

The shop owner whose experience was described in Section 3 above also saw this problem:

***"Thirty years ago all the shops were independent. Now they are all chains."***

# 5.0 Other levies, reliefs and remedies

Thus far we have focused on the impact of the rates themselves on SMEs in London. But, of course, rates payments sit within a context of other costs as well as reliefs. In this section, we examine some of this context in the form of other levies, the emerging impact of serviced offices and various reliefs and remedies.

## 5.1 Relationships with other levies

Businesses in London are subject to several levies, some of which are national and some specific to London: from the Community Infrastructure Levy to the Apprenticeship Levy and the business rates supplement to fund one third of the costs of the Elizabeth Line (Crossrail) in addition to nationally set taxes such as VAT, corporation tax and business rates. Of course, sound cases can be made for all of these levies, and we would not suggest that they are, in any way, inherently ‘bad’. In the case of the Crossrail business rate supplement, 85 per cent of business premises are exempt, so it does not generally apply to SMEs. The key point is that business rates pre-empt these levies, with no scope for offsetting.

The Local Government Finance Bill published in January 2017 included proposals for power to be made available to the Mayor of London and combined authority mayors to add a supplement to business rates to fund new infrastructure – although the incoming Government did not decide to reintroduce this Bill in the Queen’s Speech on 21 June 2017.

These other supplements have a potential – if indirect – implication for BIDs, especially in the context of local authority funding cuts, as they potentially reduce the level of resources that businesses have to contribute, thereby having an impact on the viability of BIDs and their ability to deliver local projects to improve the public realm and support local firms.

For example, research commissioned by South Bank BID[13] found that the revaluation would increase RVs by 36 per cent on average, or £50,000. Even adjusting for some extreme cases, the average increase was still £40,000. Notably, some sectors were hit harder than others, with average increases for restaurants and cafés of 100 per cent and 156 per cent respectively – compared with 23 per cent for offices. Restaurants and cafés are not footloose, so cannot relocate to reduce the impact.

The South Bank has, of course, seen large-scale regeneration over the past three decades, but even in this context the size of some increases raises questions. Nic Durston, Chief Executive of South Bank BID, told Ramidus that ***“successful businesses have no option but to pay the increased rates, but in doing so, some will undoubtedly step back from planned levels of investment and service provision”***. These are ‘bottom-line’ decisions, he says.

Compounding the impact on investment are the local government austerity measures. ***"Businesses pay the BID levy to secure additional services that reflect the needs of the neighbourhood."*** With local authorities being squeezed financially and cutting non-statutory spending, they find that businesses ***"want to see investment in the area. They pay a huge amount in business rates, and see very little by way of return"***.

The South Bank research found no direct evidence of rate increases having an impact on business closures (and therefore jobs), suggesting that the local economy is resilient. But changes in investment plans are very hard to capture in statistical analysis because it is seeking to measure 'what might have been'. There is real concern that rising RVs are squeezing out capital investment and company growth.

## 5.2 Impact of new property used for new workstyles

As noted in the opening section, business has seen significant changes in workstyles over recent years, largely driven by the impact of technology, and small businesses are as open to new workstyles as are large corporates. This, in turn, has driven the emergence of new styles of property provision, some of which are evolutions of previous patterns and others of which are more radical. Typically, these new methods aim to supply small amounts of space on easy-in, easy-out terms that are suited to a potentially wide array of occupier types. Often they will be found in older office stock or space previously used for industrial processes.

There are several models, ranging from straight rentals – essentially the same as conventional leases, but smaller and more flexible – through subsidised space and tiered offerings, to the fairly recent emergence of membership property services.

Sara Turnbull, a member of the GLA Workspace Providers Board, and past CEO of Bootstrap, a specialist workspace provider, says: ***"Everybody is being affected by rates,"*** and that it is not only the revaluation but also the impact of a 2015 Supreme Court ruling – Woolway vs Mazar – that make it significantly harder to combine hereditaments. With reliefs applying only to the first hereditament, this can reduce the scope for claiming reliefs.

***"It makes a huge difference,"*** says Turnbull, and ***"The revaluation has compounded the effect."*** London businesses that now have to pay rates also find that their valuations have increased sharply. She says that while around one third of Bootstrap clients will benefit from charitable relief and half from SBRR, a proportion will feel this double impact.

Turnbull says the problem is exacerbated by PDR eating away at supply and driving rents up. ***"Look at total occupancy costs,"*** she says. ***"They're up 300–400 per cent and only a proportion of this can be passed on. You have to look at rents and rates together."***

**"Social workspace has more purposes than to be a landlord,"** she says; ***"it is about bringing (business communities) together"***. Rising costs are driving out low-margin, high-cost occupiers and skewing the market. Specifically, they are driving out light industrial enterprises, says Turnbull, a view that should be no surprise given the sharp RV increases noted earlier in this report.

Turnbull would like to see relief for socially focused providers, accepting that this may require arbitration. But she also suggests that physical areas – perhaps as small as a single street – could be made analogous to enterprises zones, with their attendant rates relief.

We should note that other providers of specialist SME space did not feel specifically affected by the rating revaluation. One told Ramidus that, although its leases are typically for only around two years, they are in other respects normal Full Repairing and Insuring leases in which the rates are the responsibility of the tenant.

## 5.3 Reliefs and remedies

A critical factor that is masked by aggregate data is not that rates rise and fall, but that the system of exemptions and reliefs – including those announced in the recent Budget – push the burden of administration down the business hierarchy. As the Institute of Fiscal Studies put it:

***The additional revenues raised up front will then be used to fund the cost of successful appeals further down the line. These costs include refunds for 'overpayments' of people who successfully appeal their rateable values.***[14]

This seems an undue burden on the enterprises that are least equipped to cope: small businesses, for whom the primary focus is cash flow. Property adviser JLL had this to say on the system of reliefs for small business[15]:

***Another complication is relief for small businesses. Occupiers in England with a single property with a rateable value of under £12,000 will pay no rates at all (£15,000 in Scotland, £6,000 in Wales). The rates are phased in up to £15,000 (£18,000 in Scotland, £12,000 in Wales). This takes a number of small ratepayers out of rating altogether but creates two problems.***

***1) When a company crosses the threshold, the marginal rate of tax increases hugely.***

***2) The threshold is a disincentive to invest and grow as expansion leads to a substantial increase in tax.***

This strongly echoes the comments of the British Retail Consortium noted earlier. Krissie Nicolson, of East London Trades Guild, said:

***It's a postcode lottery… The Government wants SMEs to contribute but it is such a bureaucratic system. The appeals system is ridiculous.***

Referring to the help announced in the March 2017 budget, she added:

***… it will help about 60 per cent of our members, but nobody knows how it is going to work. There is a lack of transparency. How long will it take?***

In the 2017 Spring Budget, the Government announced the establishment of a £300 million discretionary fund, spread over four years from 2017/18, to support those businesses facing the steepest rises in their rates bills following the revaluation.

The Government confirmed details of the allocations of this £300 million to every billing authority in England on 28 April. They will be expected to use their share of the funding to develop discretionary relief schemes to target support at the most hard-pressed ratepayers. The £300 million will cover the four years from 2017/18 with the following profile:

- £175m in 2017/18
- £85m in 2018/19
- £35m in 2019/20
- £5m in 2020/21

Of the £300 million fund, £124 million will be payable to London, which at 41 per cent reflects the share of the total increase in rates bills for properties with an RV of below £200,000

London overall will receive up to £72.5 million from this fund in 2017/18, ranging from £421,000 for the Borough of Kingston to £11.6 million for the City of Westminster. A further maximum of £35.2 million is payable to London in 2018/19, £14.5 million in 2019/20 and £2.1 million in 2020/21. This is the total funding available for reliefs with the Government, under the business rates retention system, bearing a proportion of the costs and compensating local authorities for the share they bear (67% in London in 2017/18) via grant.

The Government also announced a special supporting small business relief to provide a cap on the increases in bills being faced by ratepayers losing eligibility for small business rate relief as their new valuation exceeds £15,000.

For 2016/17, eligible ratepayers with a rateable value of less than or equal to £6,000 were entitled to 100 per cent small business rate relief. Those with an RV of between £6,000 and £12,000 enjoy tapered relief from 100 per cent to 0 per cent. Following the measures in the 2016 Budget, the Government increased these thresholds from 1 April 2017 to £12,000 for the 100 per cent relief and £15,000 for the tapered relief. This ensured that most ratepayers currently entitled to small business rate relief would pay less or nothing following the revaluation. However, some ratepayers who are facing large increases in their rateable value will lose some or all of their small business rate relief – which means that they could be facing increases in bills of £3,000 or more overnight when, up to April 2017, they had been paying negligible sums and were not subject to the 5 per cent real-terms cap on increases for small properties.[16]

The new small business relief announced in the Budget was designed to address this anomaly and ensure that the annual increase in the bills of these ratepayers is limited to the greater of either

- a cash value of £600 per year (£50 per month), ensuring that those ratepayers currently paying nothing or very small amounts are brought into paying something; or
- the matching cap on increases for small properties in the transitional relief scheme.

The following worked example (Figure 12), provided by the GLA, is based on the situation facing a small shop in Bermondsey, which was previously below the £6,000 threshold and now has an RV of £19,000. This worked example is a small firm which had an RV of £5,800 in 2016/17 and was eligible for SBRR. Because its RV increased to above £15,000, it lost its relief.

Although this clearly demonstrates a saving from the Budget announcement, a more substantial point remains. A £19,000 RV in Bermondsey suggests a small unit. Assuming a March 2016 office rent of £300 per sq m – which is not unreasonable for secondary space in that area – this equates to a unit size of around 63 sq m. Using industry-standard density assumptions, this is an enterprise of six to seven staff. If the unit is industrial, then, on the basis of a rental value of £120 per sq m, this breaks back to a unit of approximately 158 sq m, with light industrial densities implying three to four staff.

**Figure 12 Worked example: Losing SBRR and the Budget measures**

| Year | Small property TR cap (%) | Figures in £s | | | |
|---|---|---|---|---|---|
| | | Option 1 cap | Option 2 cap | Actual bill post budget (greater of £600 or TR increase) | Saving post budget |
| | | Transitional relief increase (pre-budget bill) | £600 year on year cap | | |
| 2016-17 | N/A | 0 | 0 | 0 | 0 |
| 2017-18 | 5.0 | 3,006 | 600 | 600 | -2,406 |
| 2018-19 | 7.5 | 3,231 | 1,200 | 1,200 | -2,031 |
| 2019-20 | 10.0 | 3,555 | 1,800 | 1,800 | -1,755 |
| 2020-21 | 15.0 | 4,088 | 2,400 | 2,400 | -1,688 |
| 2021-22 | 15.0 | 4,701 | 3,000 | 3,013 | -1,688 |
| Total | | 18,581 | 9,000 | 9,013 | -9,568 |

There is no standard by which either of these scenarios is anything other than a small enterprise. Nevertheless, even the £9,000 or rates payable under the post-budget scheme is a direct deduction from the bottom line, and the option for offsetting against other factors is minimal. Put bluntly, an exemption threshold of £12,000 or £15,000 offers no help to enterprises of this size in Inner London and the remedies only partially mitigate the impact.

During the General Election campaign, the FSB expressed concern that, contrary to undertakings from Government, the election was causing delays in securing access to these remedies.

Mike Cherry, FSB National Chairman, said: ***"Small businesses were given a cast-iron guarantee that the General Election would not delay implementation of rates relief initiatives."*** The £300 million hardship fund for councils promised by the Chancellor and the Communities Secretary in the Budget was a significant win that FSB fought hard to achieve. Cherry continued:

***Every local authority has known its fund allocation since April, so they should not be chasing small business owners for inflated bills as they have not got around to devising their distribution schemes. FSB calls on Government to issue guidance to local authorities that puts a moratorium on pursuing small businesses for these incorrect bills – which would need to be refunded as soon as a local authority gets its house in order.***

***The first order of business for the Communities Secretary in the next Government should be to get a grip and make sure the promised help is delivered in the first month of office.***

At the time of writing, owing to delays in updating software, the impact of the General Election and the new consultation means that many councils have still to set an implementation date for the roll-out of these local schemes and the supporting small business scheme.

# 6.0 FSB membership feedback

At the start of 2017, the FSB surveyed its London members about the issues facing them in the coming year. Nearly three quarters (73.9%) of respondents cited the rating revaluation as the most important concern to their business (Figure 13). In contrast, 'Recruiting the right skilled staff' and 'Car parking', were cited by 33.6 per cent and 24.6 per cent of respondents respectively. Perhaps most striking is that 'Economic uncertainty' was cited by only 36.6 per cent of respondents, arguably a surprising result given the ongoing Brexit process. The fact that it has triggered such a strong response is a sign of how disruptive to London business the revaluation is.

**Figure 13 Major issues for 2017 cited by small businesses**
*Source: FSB*

| Issue | Percent citing |
|---|---|
| Business rates | 73.9 |
| Economic uncertainty | 36.6 |
| Recruiting the right skilled staff | 33.6 |
| Car parking | 24.6 |
| Office or business space | 19.4 |
| Access to funding | 17.2 |
| Other (please specifiy) | 17.0 |
| Business support | 14.9 |
| Infrastructure - telecommunications/broadband etc | 11.2 |
| Broadband | 10.4 |
| Crime/cyber security | 10.4 |
| Procurement opportunities | 9.7 |
| Planning regulations | 7.5 |
| Strikes | 6.7 |
| Infrastructure - transport | 6.0 |
| Transport charges | 5.2 |
| Import/export support | 2.2 |

When asked what their likely responses would be, only 15.7 per cent said there would be no impact (Figure 14). Nearly one third stated that they would cut back on capital expenditure, while 20.1 per cent said they would reduce headcount.

**Figure 14 Likely responses to rating revaluation**

*Source: FSB*

| Likely impact of rates revaluation | Percent citing |
|---|---|
| I will cut back on capital expenditure | 32.8 |
| I will look to shut my business | 23.1 |
| I will reduce headcount | 20.1 |
| I will move location further away from the centre of London | 18.7 |
| No impact | 15.7 |
| Move my business into a home address | 10.4 |
| I will take on my work/increase capacity/increase operating hours | 9.7 |
| It will encourage me to invest in new markets | 4.5 |
| I will take on more staff | 1.5 |

Most concerning is that nearly a quarter stated they would look at shutting their business, with another fifth saying they would seek to move further from the centre of London, while 10.4 per cent said they would move their business to home.

Figure 15 lists additional comments made by respondents on the impact of the rating revaluation. While some responses are fairly matter-of-fact, that some cite the likelihood of closing their business is startling. Further, it is fair to say that some respondents expect their rates bills to choke off spending in areas directly related to business activities, such as staffing and capital spending.

**Figure 15 FSB member responses on rates revaluation**

*Source: FSB*

- *Reduce other spending/investments in the business/freeze pay increases.*
- *Look to reduce other overheads.*
- *Rent and rates are a huge overhead. Will review over next five years and most probably shut the business.*
- *Business rates killed my last business and so I work from home now and am looking to convert my attic rather than pay business rates.*
- *We run six venues and increases at a number of these sites mean they are no longer profitable and need to close.*
- *I don't really know - we are barely able to survive at the moment.*
- *We will reduce the size of office space occupied and reduce headroom for growth.*
- *As we cannot pass on this ridiculous increase to our customers, we somehow have to reduce expenditure to cover this unexpected increase, including also looking at alternative less costly premises.*
- *Reduced revenue for healthcare.*
- *I'm trying to move my business out of my home and into a shop, but business rates for a small independent business are already prohibitive. Any rise will make it even harder.*
- *Likely to affect my ability to move into business premises - currently working from home.*
- *I don't know: as a sole trader renting an office, my business rates are included in the rent, which I will assume will continue to rise.*
- *It will have a knock-on cost to me from suppliers.*
- *I can't move so it just hits EBITDA and so growth, recruitment and profits (corporation tax).*
- *Reduce office space*
- *I have already given notice on our lease. The raise in rates makes the premises unviable and poor value for money.*
- *Am considering moving business from UK.*
- *Increased costs, need to review options.*

These are stark quotes, entirely consistent with the feelings expressed in the case studies above. It is strongly suggestive of a rating system that is having significant unintended consequences for small businesses.

# 7.0 Conclusions and recommendations

## 7.1 Conclusions

Analysing business rates is a challenge because publicly available information is either heavily aggregated or designed for use by individual rate-paying entities. Borough-level data give a very broad-brush picture and allow some insight into impacts at local level. For example, nobody should be surprised that retail RVs have begun to rise in Newham as the Westfield Stratford City shopping centre has opened and investment relating to the 2012 Olympics has begun to crystallise. But the aggregate data mask detail and geographical variability. The same revaluation that increases the RV for (say) an international chain coffee outlet will do the same for a local independent café.

On a larger scale, it is not unreasonable that the most prosperous areas should contribute more. But, even after netting out transitional relief, the 2010 revaluation added around £2.2 billion to London's business costs. There is no reason to believe that the new revaluation will have any less impact, even after various reliefs have been taken into account.

Rates, of course, are far from the only challenge and change faced by retail over the past three decades but it does seem that, taken in the round, their operation can compound pressures that already put strain on independent stores. Rates may be an easy tax to gather – provided that the administrative burden is pushed down the line as far as possible – but it is not well suited to supporting urban diversity. The FSB, in its manifesto for the 2017 General Election, put it this way:

***Business rates now affect the very make-up of all our local business communities, creating empty spaces on our high streets. Changes proposed to the appeals system increase the barriers to those businesses who seek to challenge the valuator's assessment of their property value. This is particularly poor considering the significant numbers of appeals granted so far after the last revaluation in 2010 (at 2008 prices), with more cases still to be heard, caught up in a backlog.***

The research here has shown that the rates system in London is placing a very heavy burden on small businesses, threatening some with closure, preventing new investment in others and stifling growth in many. Although beyond the detailed scope of this report, it is also easy to suggest that business rates do not effectively support wider urban regeneration and development policies. So what can be done to overhaul a system that is not fit for purpose?

The following recommendations are directed at what the Government could do to create a system of rates that is more sensitive to, and better supports, the needs of London's SMEs.

## 7.2 Short-term recommendations

**Create a more sophisticated system of thresholds and reliefs to reflect higher values in London and avoid 'cliff-edge' changes in occupier liabilities.**

More-realistic thresholds need to be set and the value differential between Inner and Outer London needs to be properly reflected.

- Inner London: the threshold should be £20,000 RV for 100 per cent relief, tapering to £23,000.
- Outer London: here RVs have increased by a lower percentage, and the threshold for 100 per cent relief should be set at £15,000, tapering to £18,000.

The system of thresholds in the rating system is an across-the-board system. The £12,000 threshold used in the 2017 revaluation applies whether a business is in Newcastle or New Bond Street. The attraction of a single national rate from the point of view of public administrators is obvious: it is clear and unambiguous.

But London is not the same as (say) Manchester, and central London is not the same as the rest of London. The huge differences in value between central London and virtually everywhere else in the UK mean that in London the quantum of space available at exempt levels is very small. For example, in Westminster, where the average RV for offices is £462 per sq m, a unit hitting the £12,000 threshold would be just 26 sq m in size (£12,000/£462 per sq m). This would accommodate two or three staff at standard occupation densities for offices.

This is similar in principle to the British Beer & Pub Association research, which calls for the threshold of SBR to be increased to £18,000, arguing that this would take 7,500 pubs (not just in London) into its scope.

This would give a greater cushion to growing businesses by keeping them exempt for a longer period.

**Review the new CCA system, introduced in 2017, after its first year of operation to ensure that the system is operating fairly and efficiently and that small businesses are not being disadvantaged by the apparent complexity of the system because they are unable to afford independent advice.**

The Government has introduced this new appeals system for the 2017 revaluation. Any new system needs to be critically evaluated to ensure it will work as intended, will achieve its objectives and will not simply place more burdens on ratepayers. Even before it came in, expert observers were expressing scepticism.[17]

**The Government should extend the local discretionary relief scheme announced in the March 2017 Budget and maintain levels of support in 2018/19 at the same level as 2017/18 – or at the very least confirm that local authorities will be allowed to reprofile their year-one funding to prevent many businesses from facing very large cliff-edge rises in future years and ensure that the full £300 million pot is allocated to businesses.**

## 7.3 Medium-term recommendations

### Ensure a properly resourced VOA

The VOA has seen as much cost-cutting as other departments, with local offices closed. This has contributed to the increase in mistakes in assessments and unresolved appeals. While the updated CCA process might improve the situation, there is a backlog of 250,000 appeals still to be resolved from the 2010 revaluation.

It also needs to be made more accountable in performance terms to those affected by its decisions – local authorities and ratepayers. This should also extend to the Valuation Tribunal, which will be taking on responsibility for administering the final appeals stage of the new CCA system.

### Speedier revaluations

We have said that the Government should shorten the two-year period required to prepare a revaluation.

### More frequent revaluations

Nearly all commentators agree[18] that revaluations should take place more frequently, with a consensus that biennial or, failing that, triennial revaluations would be most appropriate.

This would certainly alleviate the 'shock' effect of infrequent revaluations, but needs to be more firmly entrenched. The Institute of Fiscal Studies[19] argues that more-frequent revaluations would eliminate the need for the complex array of transitional reliefs because:

***… in general it takes time for large changes in property values to occur. More- frequent revaluation would also mean that rates bills are based on more up-to-date information on local economic conditions – whereas transitional relief delays that adjustment process.***

The 2017 revaluation was delayed by two years for entirely political reasons, and this is far from the first time that a sitting Government has delayed revaluations for fear of electoral consequences. This is unfair on all businesses, but even more so for smaller businesses trying to manage cash flow. Whether the frequency of revaluation changes or not, businesses need to know that scheduled revaluations will happen. In its election manifesto, the Government committed itself to a review of business rates and we would encourage it to start this as soon as possible, in order to ensure that changes can be implemented in time for the next scheduled revaluation in 2022 – this should include an early firm commitment that 2022 will be the last five-yearly revaluation.

## 7.4 Long-term recommendations

### Major review of the entire non-domestic property taxation system, regionalised for London and other large cities

A significant part of the controversy surrounding business rates stems from the fact that they are centralised. This system was created in the 1980s in response to what the Government of the day saw as profligacy by local authorities, which cost jobs.

But any system has its benefits and disadvantages and, over successive revaluation periods, the inflexibility of a centralised system has spawned the array of reliefs and remedies detailed above.

It may well be time to revisit where responsibility for the setting of rates resides. This is not necessarily a call for a return to the ***status quo ante*** but a suggestion that the larger cities are now much more attuned to the needs of their local businesses – and less ideological – than was arguably the case before, and are also much more aware of the costs of doing business in their local area.

As part of this review, consideration could be given to the extent to which local taxation should be devolved, including the 100 per cent devolution model proposed by the Government in the Local Government Finance Bill and the London Finance Commission's more radical proposals for devolution of tax-setting powers (which have been strongly endorsed by the current and previous Mayors of London). While it would be inappropriate for this report to take a position on such a matter, the analysis does suggest that, one way or another, business rates must be made to be more locally sensitive.

Business rates and domestic property taxation are already devolved in Scotland, Wales and Northern Ireland – with Wales having its own regional VOA arm. We see no reason why, with proper infrastructure and governance, London and other English combined authority areas and regions with larger populations and property tax bases should not also be able to deliver and administer business rates sub-regionally.

Pressure for reform is growing instead of diminishing and reform will be hard to avoid. In its 2017 General Election manifesto, FSB said:

***The next Government will inherit a system in England that will create more tensions as the next parliament progresses. It should, therefore, commit to a review of non-domestic rates, either by creating a cross-party independent review under a pre-eminent independent figure, or establishing a Royal Commission. This would take politics out of the process. The Commission would be tasked with designing a new system for securing small business contributions to the funding of local services that more accurately reflects a business's ability to pay.***

The linking of contributions with the ability to pay lies at the heart of the matter. Furthermore, it should be possible for a Commission to make recommendations for a new system to come into force before the end of the next parliament.

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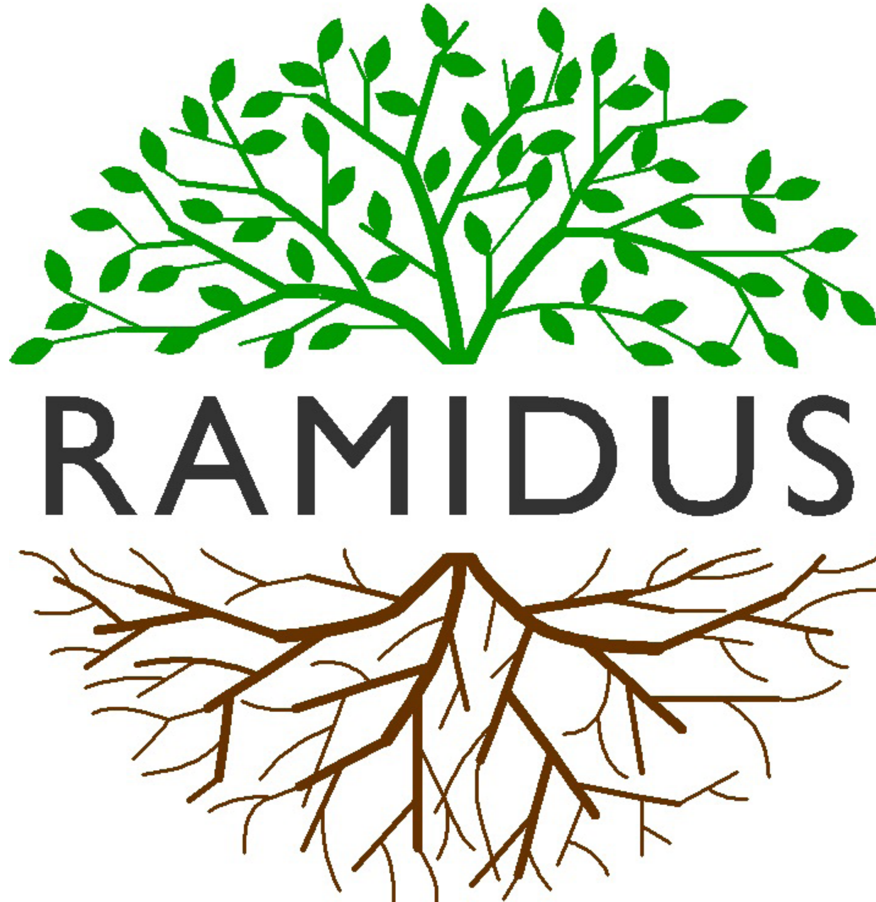


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