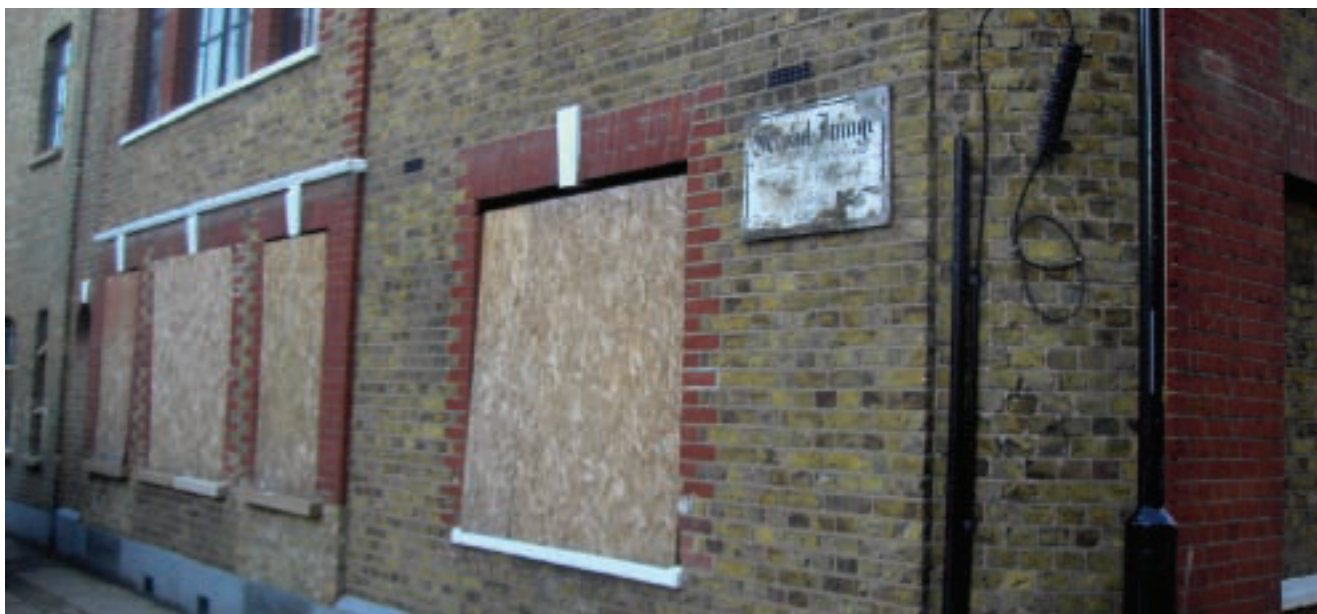


BUILDING THE HIVE

Mounting pressures will affect property valuations, leading to a busy time for solicitors, claims **Stephanie Dale**



The value of commercial property portfolios is being attacked on four sides, and owners may need to take action before April 2008 to minimise the impact, according to commercial solicitor Jeremy Redfern, partner at Parkinson Wright LLP in Worcester. The mounting pressures on valuations come from a combination of the Rating (Empty Properties) Act 2007, credit crunch, proposed changes to capital gains tax and Energy Performance Certificates being required for certain properties.

Rating (Empty Properties) Act 2007

The Rating (Empty Properties) Act 2007 was passed in July. From 1 April 2008, commercial landlords with empty properties face a sizeable business rates demand. Under current rules, most commercial properties gain 100 per cent rate relief for three months that the property is vacant and 50 per cent thereafter. Factories and warehouses receive 100 per cent permanent relief. Although the complete regulations of the new Act are yet to be decided, the Act allows owners of commercial properties to pay nothing for three months, but then the full rates apply. Industrial properties and warehouses pay nothing for the first six months, then the full rates, if still empty.

"This will have a negative impact on speculative development, as the potential additional business rate costs will cut investment return. This could cause a reduction in supply of properties leading to increased rents. The valuation of secondary and marginal property will be seriously affected, and it will impact on the valuations of property portfolios, which may, in turn, affect financial loan agreements," said Mr Redfern.

As a result of the Act, many commercial property owners will probably consider selling secondary and tertiary property rather than keeping it empty to avoid the extra rates costs, diminishing returns further. This is likely to mean an increase in such properties coming to the market, leading to depressed prices. Mike Debens commercial property partner of Downs Solicitors LLP in Dorking, commented: "On its own, the Act may not have a significant impact, but with other changes coming together, the effect is likely to be more pronounced. The new Act adds to the current attitude that businesses don't want to keep property empty".

Credit crunch

The credit crunch has led to financial institutions taking a more cautious approach to lending. Valuations are assessed more critically. The percentage of loan to valuation that some institutions are willing to lend is reducing. In addition, borrowers are charged more, regardless of the movement of the Bank of England interest rates. This makes it increasingly difficult to obtain loans

at acceptable costs, resulting in deals starting to fall through. "We have seen a number of deals that would have gone ahead now abandoned or on hold because the cost of borrowing has gone up or the amount of money that banks will lend has been reduced," said Mr Debens.

The Institute of Directors (IoD) said that "the impact of the financial crisis is clearly seen in the latest quarterly Business Opinion Survey [October 2007]". Six per cent of company directors report an increase in the cost of borrowing, and seven per cent report new restrictions on borrowing. Graeme Leach, chief economist at the IoD, said: "Across the whole economy there is a real divide between the actual impact of the financial crisis to date and the expectations of what it might bring in the future. The key question now is whether optimism will bounce back, because if it doesn't, business investment could be hammered."

Capital gains tax

The taxing of gains was introduced in 1962 by Tory Chancellor Selwyn Lloyd with a "speculative gains tax" on land sold within three years of purchase or shares sold within six months. It was based on income tax rates of up to 80 per cent. Over the years, the tax has been modified in terms of what it covered, the rates and relief. From 1982 until 1998, indexation of capital gains meant the effect of inflation was taken into account when evaluating the taxable gain made. Taper relief was then introduced, which meant the longer an asset was held, the lower the tax paid.

Currently, for a business asset sold after two years, 75 per cent of the gain is relieved, meaning only 25 per cent of it is paid. If the owner is a 40 per cent tax payer, the tax paid is effectively 10 per cent of the capital gain. For a non-business asset, the taper relief reduces over 10 years down to 40 per cent relief, meaning 60 per cent of the gain is paid. If the owner pays tax at 40 per cent, the effect of tapering brings the rate down to 24 per cent of the gain – or less if they are a

lower rate tax payer. For assets owned prior to 1998, indexation applies up to 1998. The Chancellor, Alistair Darling, has announced that capital gains tax (CGT) will be payable at a flat rate of 18 per cent, and indexation relief will go. Recent lobbying may affect the final details.

The effect of the proposed changes to CGT means, on the face of it, that people with business assets to sell, owned for more than two years, will pay less tax if the sale completes prior to 6 April 2008, but if they have non-business assets, such as investment property, they would generally be better off if they sell after 6 April 2008.

"If businesses have taper relief available now, owners will want to sell before the end of the tax year and then hope that they can find someone who can get the required funding. For sellers, the benefits of securing a sale before the deadline in turn provides an opportunity for buyers to seek a share of those benefits. It puts them in a strong negotiating position," said Mr Debens.

Solicitor Kevin Box of M & S Solicitors in Leicester added: "There is a realistic chance that we will see people wanting to dispose of property in the New Year as they start to understand the implications of the new tax". This is likely to lead to a short-term increase in the volume of work undertaken by certain solicitors. "For buy-to-let investors, if they have owned property for a considerable period and gain indexation relief, they may be better off disposing of the property before 6 April 2008, otherwise delay until after that date. I don't think the reduced tax regime will encourage people to get into the buy-to-let market though, as property values will probably go down, so they may possibly invest when they have dropped," said Mr Box.

Energy Performance Certificates

Energy Performance Certificates (EPCs) are required on all buildings (other than dwellings), constructed, for sale or rent by 1 October 2008. A staged timetable has been planned, depending on the size of the property. This is likely to put added pressure on secondary and marginal properties where the owner needs to invest in the properties to get them up to standard compared to newer ones. Owners may consider selling empty properties, prior to the requirement for EPCs, adding further volume to the market and downward impetus to valuations. See related article in issue 20 (September 2007).

Summary

Business asset owners will want to assess the implications of the Rating (Empty Properties) Act 2007, the effect of the credit crunch if they offer assets for sale, the changes in CGT where they apply and the impact of EPCs, particularly on secondary property. For non-business asset owners, the loss of indexation relief will influence their decision whether to sell before or after 5 April next year. The changes in CGT are not clear cut, and further

amendments may be made, making the timing decision more problematic. Whatever happens, it is likely to lead to an increase in the volume of work for commercial property solicitors.

Many commercial property owners will probably consider selling secondary and tertiary property rather than keeping it empty to avoid the extra rates costs.

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