

Executive Summary

- 1 The overall objective of this study was to examine whether rents changed in response to an exemption from National Non Domestic Rates (NNDR, also known as business rates). The method adopted was to use Enterprise Zones (EZs), where no business rates were payable while the zone was in force, as a control group against which to assess properties with similar characteristics but receiving no relief from business rates. The nature of the relationship between rents and NNDR was investigated using the change in EZ-related NNDR status as the trigger point for altering the negotiation stance between landlord and tenant.
- 2 The main conclusion is that 100% of the benefits from NNDR relief are passed into rents and therefore accrue to landlords, although the range of uncertainty surrounding this statistical estimate¹ puts the boundary at somewhere between 65% and 150%. Either way, the general conclusion is that the majority of tax-saving benefits from NNDR exemption on EZs accrued to landlords rather than to tenants.
- 3 Most of the previous literature has investigated the impact of variations in local taxes on property capital values. Much of this work has been undertaken in the United States. Relatively little work has been undertaken to assess the effect of spatial variations in taxes on commercial property prices and rents. In the United Kingdom research undertaken as part of the national evaluation of EZs provides some support for the thesis that, other things being equal, reductions in local taxes can cause local rents to rise by up to 50%. Earlier work on the EZs pointed to a capitalisation of around or over 50-60%, but this varied by the zone.
- 4 The data for the study were supplied by the Valuation Office Agency (VOA), which obtained the data by using a mix of digital mapping techniques and by requests addressed to local VOA offices. The variables obtained represented a mix of characteristics that could affect the rental value (and hence rateable value) of a property, and the details of the rent process itself. The following core set of indicators was used in the study: the number of businesses on and off-zone, spread of different business types, types of tenure, rent or lease term, age profile of properties, effective size of the properties and rental payments
- 5 The data available for the study governed the choice of methodology. Two specifications were ultimately arrived at. The first specification used dummy variables to establish whether rents were higher in the EZs during the rate relief period and whether there was evidence for subsequent convergence between on and off-zone rents. The second specification employed a measure of the tax saving accruing to properties renting on-zone during the EZ lifetime to establish the degree of capitalisation. Although EZs were active for ten years, the analysis for the first specification was limited to the period 1990-93 due to the need to have a consistent dataset in terms of the EZ period of operation.
- 6 The results suggest that there is evidence that rents move in response to a change in NNDR. The average capitalisation effect obtained across the sectors was not significantly different from 100% (although statistically, as mentioned above, this

¹At the 95% level of confidence, the value of a coefficient can be said to lie approximately between +/- 2 standard errors of the point estimate.

point estimate is part of a possible range from 65% to 150%), implying that all, or certainly most, of the NNDR exemption benefits accrue to the owners of the property. The implication of this is that a net present value increase in tax savings of £1 will result in a £1 increase in rents. In addition, the specification with a dummy variable to measure the mark up of rents commencing during the four available years of zone lifetime, showed that, on average, new rents were about 10% higher in the EZ during this period, although the statistically acceptable range is between 2% and 17%. Both of the previous evaluations of EZs in the United Kingdom (Department of Environment, 1987, 1995) found that rents were, in general, higher on the zone but tended to converge towards the end of the life of the zone.

- 7 The analysis of whether there was any evidence of a significant convergence effect from EZ rents was impaired by the relatively short time over which the assessment could be made. It was also the case that the general trend in rents was downwards, which could have obscured the more marginal effects expected to occur in the EZs only. Previous work, most notably undertaken as part of the National Evaluation of Enterprise Zones (Department of Environment, 1995), found clear evidence for convergence.
- 8 For the first specification looking at rental mark-up effects, a reasonable degree of variation across sectors was found: the wholesale and office markets stood out with a particularly high mark-up, while manufacturing showed a smaller and statistically insignificant effect.
- 9 The individual sector results for the tax-saving specification also display variation around the average result. The manufacturing sector had the incidence of tax savings being incorporated into rents closest to the average (93%), while the wholesale sector was higher and the office sector much lower (and insignificant).
- 10 It is not clear why the office market had high mark-up of rents during the EZ period but an insignificant incident of capitalisation of tax savings into rents, and vice versa for the manufacturing sector. It might be expected that the two should go hand in hand, as they appear to do for the wholesale sector.
- 11 The study has demonstrated that it is possible to use the VOA data relating to EZs and their surrounding areas to assess how commercial property rents move in response to changes in local business taxes. However, getting the data into a form that can be analysed has presented a considerable challenge. Modelling the impact of tax change has also provoked some interesting conceptual and measurement issues, but much has been learnt as to how the work might be progressed in the future.
- 12 In addition to the range of uncertainty concerning the econometric estimates of capitalisation and mark-up effects, there is a possibility that the results may be in part driven by a bias resulting from omitted variables (in particular, other benefits accruing from EZ location), endogeneity of the tax-saving variable (exogeneity is assumed, not tested), and a general concern over the quality of the data.
- 13 Future work could usefully investigate some of the caveats and unexamined issues surrounding the results, namely the extent to which the findings presented are influenced by the fact that properties in EZs experienced other benefits besides the NNDR savings (and whether this is the reason for some results showing rents

changing by more than the NNDR saving), the cause of high mark-up of rents where there is no evidence of significant capitalisation of tax savings into rents, and why high capitalisation of tax saving into rents does not always result in a mark-up of rents, and whether the results are symmetric (eg would a £1 increase in rates result in a £1 fall in rents?).