

Summer/Autumn 2008

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Surveying trends

Empty business rates hit commercial property market

It's now over three months since commercial property owners became subject to new regulations relating to business rates on empty commercial and industrial properties. This has had a significant affect on the commercial property market.

Previously, vacant industrial and warehouse buildings got complete exemption from business rates that were paid on occupied premises, until they came back into use. Office and retail premises that were unoccupied could qualify for a three month exemption, after which they could claim a minimum of 50 per cent relief.

The new regulations allow full relief for vacant industrial and warehouse premises for the first six months, with a similar relief for office and retail premises for the first three months. Rate relief for these properties then ends and the full non-domestic business rates are chargeable. What came as a surprise to the industry was the fact that landlords received bills for the full business rates on 1 April 2008, the day the new reforms came into effect, for industrial and warehouse premises that had been empty for six months, and for offices and shops that had been vacant for three months prior to this date.

The logic behind the new regulations is that the original reliefs were introduced back in the 1980's, during a period of recession, to assist property owners in difficult times. The government questioned whether such tax breaks should be offered in the recent strong commercial property sector and believed the reforms would encourage re-development of vacant sites or empty property, although when the legislation was made they clearly could not

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predict the recent financial turmoil and its effect on the commercial property market.

One positive note is that recent reports indicate the government are considering the impact of empty rates as part of a wider review, in light of current economic conditions. Any concessions in favour of owners of empty properties will be welcome.

There have been reports of bankruptcies as the empty rates tax has hit both developers and occupiers. It is also likely that the reforms may deter speculative development. One certainty is that the new regulations will generate revenue for the government, with this being estimated at £1billion in 2008/2009. Given current economic conditions and the state of the commercial property market the new regulations need immediate review if the original intention of re-energising the commercial property market is to be achieved.



Income increases with costs being controlled

Liquidity problems have not yet fed through to results being reported by agencies with increases in profit margins.

In the period under review income rose as agents benefited from a rise in activity prior to the introduction of Home Information Packs (HIPs). This did though create a temporary 'blip' in the market with agents reporting a decrease in both supply and demand in the latter part of last year. However, the recent turmoil in the financial markets and liquidity problems within financial institutions has not yet fed through to the financial results being reported by agencies.

There has been a significant correction to prices in the market in terms of valuations for both commercial and residential stock and the question now seems to be for how long the liquidity problems and price falls will continue. Some recent reports indicate that this could be for a period of up to two years, which is not good news for agencies. At least the market has not suffered the 'crash' that was widely predicted. It will be interesting to see how agencies cope with the current markets although anecdotal evidence suggests that the practices that tend to survive such depressed markets are those that take immediate steps to respond to the market conditions and align costs to revenue.

There are already reports of significant job losses in the sector and a 'tightening of purse strings', which will no doubt become more prevalent the longer the situation continues.

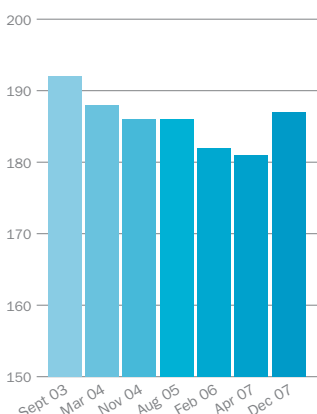
Turnover increased considerably in the period reported, and although costs have also risen the increase in turnover outstripped the increase in employment costs, resulting in an increase in the ratio of turnover to employment costs to 187%, compared with 181% previously. The last time that this level was achieved was in early 2004. The operating profit margin on turnover has also increased from 12.8% to 13.9% as a reflection of the control over costs, again returning to levels last achieved in early 2004. This fed through to an increase in pre-tax profit margins on turnover, up from 11.3% to 12.64%.

Productivity as measured by turnover per head now stands at £55,819 compared with £54,076 as previously reported. Employment costs per head fell slightly to £29,818 from £29,919 demonstrating how well agencies controlled staff costs given their increased activity. Improvements in productivity and the control of costs resulted in an increase in average operating profit per head from £6,939 to £7,734. These margins are likely to be under severe pressure in the current market.

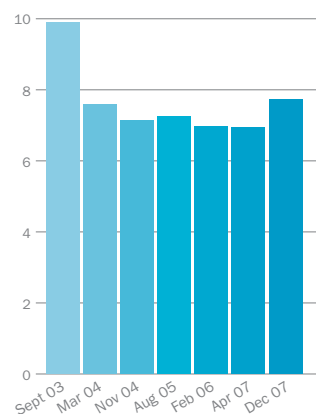
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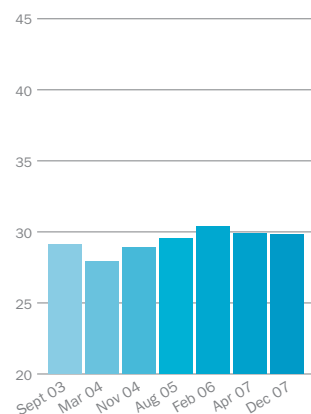
Turnover: employment costs (%)



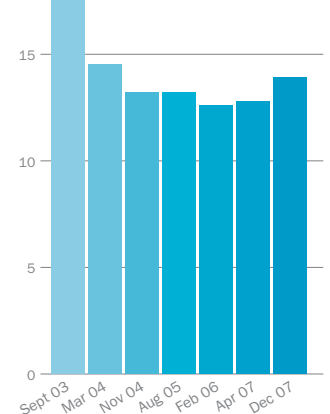
Operating profit per head (000's)



Employment costs per head (000's)



Operating profit margin on turnover (%)



Productivity improves as turnover increases

Despite rising costs increased turnover improves overall performance.

The trend in increased turnover appears to be back on track following a decline in activity previously reported. This, coupled with a more reduced increase in costs, in particular staff costs, has led to a much improved overall performance. Clearly the recent market conditions have not fed through to reported results.

The increased turnover is due to the investment market remaining buoyant despite interest rate pressures, coupled with some record prices being achieved in the commercial market and also growth in other areas, in particular international business. Recent reports that demand for commercial property has fallen at its fastest pace for over six years will surely reverse this trend. Current market conditions are also not helped by the recent changes to rate relief for empty properties, meaning that tax breaks that were previously given for empty properties are vastly restricted. In particular there are reports of large amounts of industrial space available, which will put a strain on growth in property rental. There is also over supply in both the office and retail sector.

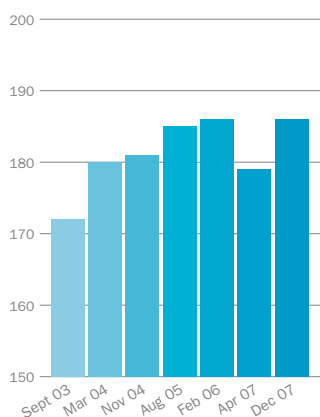
The ratio of turnover to employment costs is back up to 186% following its drop to 179% reported last time. This is still well below the benchmark figure of 200% which has now not been achieved for five years. Staff costs now stand at an average of £41,586 per head compared to £40,999 previously, although there are indicators that attempts are being made to keep these under control. Operating profit now stands at its highest level in over 10 years at 11.4%, when measured as a percentage of turnover.



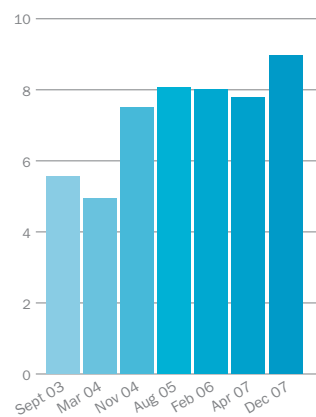
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The increase in staffing levels noted previously now seem to be reaping dividends as productivity improves with income generated per member of staff rising from £73,198 to £77,207. The knock-on effect of this is a leap in operating profit per head from £7,777 to £8,978. These improvements are sure to be short lived given the current unique market conditions and low levels of confidence in the retail, office and industrial sectors, although there are always opportunities, in particular yields are beginning to look like they could potentially offer more value in the current market. It will be interesting to see how practices react to the difficult market conditions.

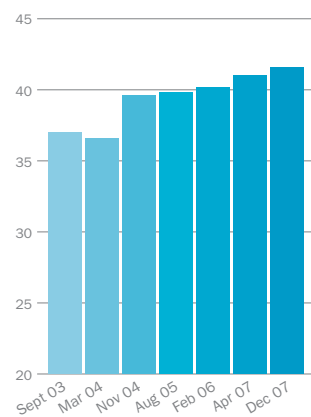
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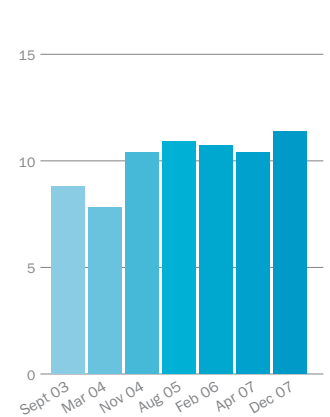
Operating profit per head (000's)



Employment costs per head (000's)



Operating profit margin on turnover (%)



Profitability hit as costs increase

Increasing turnover dampened by significant rises in employment costs.

Despite the fact that record levels of turnover are being reported, operating results are considerably down as a result of significant increases in costs. Employment costs per head have risen substantially from £39,131 to £41,742 resulting in a drop in turnover to employment costs from 183% to 177%. This is all on the back of a dramatic rise in turnover demonstrating that tighter controls over costs are needed.



As previously reported wage inflation is currently running well above the national average and this sector appears to be the hardest hit by this inflationary pressure. The one positive side to this is the increased productivity as reported by turnover per head, which is now £73,993 up from £71,577 last time, the previous best reported figure for this sector. Costs now need to be controlled, particularly in the light of the current market conditions.

The construction industry is reporting a slowdown in activity for 2008 and declines in new orders are likely to feed through to 2009. The worst hit sector is private housing, with a fall in commercial property prices and over-supply in this sector also having an adverse affect on activity within quantity surveying practices.

There have been some important developments in the sector with a trend for some firms to move away from traditional partnerships to corporate structures, some of which have gone for stock market listings. There have also been reports of consolidation, with more planned in the future, particularly by the listed entities that are looking to grow through acquisition. It will be interesting to see how they fare in the current market.

Contact Us

If you would like to discuss any of the matters arising in this edition or how we can help you, please contact either Julie Walsh on 020 7566 3800 or Jonathan Seymour on 020 8848 5500 or email jwalsh@kingstonsmith.co.uk

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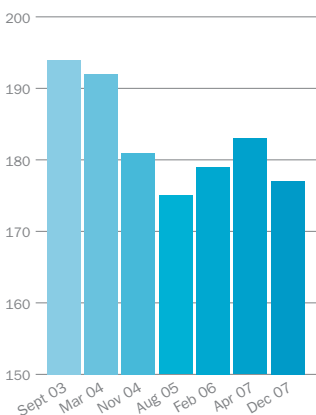
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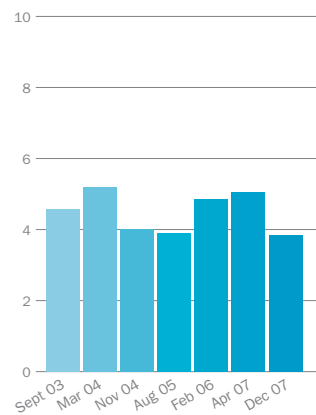
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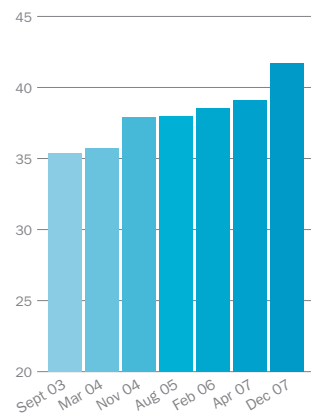
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