Scottish Parliament Finance Committee

Land and Buildings Transaction Tax (LBTT) Call for Evidence

Response from RICS in Scotland

The impact on both the residential and commercial property market of the various rates and bands.

1. The table below shows the LBTT Revenue 2015-16

<table>
<thead>
<tr>
<th></th>
<th>Residential</th>
<th>Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expected:</strong></td>
<td>235m</td>
<td>146m</td>
</tr>
<tr>
<td><strong>Actual:</strong></td>
<td>201.9m</td>
<td>214.2m</td>
</tr>
<tr>
<td><strong>Shortfall/Surplus:</strong></td>
<td>-33.1m</td>
<td>+68.2m</td>
</tr>
</tbody>
</table>

2. It is very apparent that the high level performance of commercial transactions, which returned a surplus of £68.2m, led to overall LBTT revenue exceeding expectations.

3. It leaves, however, a concerning cavity from residential returns which the £20m reduction in the Barnett Formula block grant cannot make up.

Market Assistance

4. To assess this cavity, the Finance Committee needs to consider forestalling (which will be reviewed later), and the number of house sales and revenue generated from LBTT and the preceding Stamp Duty Land Tax (SDLT) regime outlined in the table¹ below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total transactions</th>
<th>Revenue (£)</th>
<th>Average Tax Paid (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013-14 (SDLT)</td>
<td>89,150</td>
<td>215m</td>
<td>2,412</td>
</tr>
<tr>
<td>2014-15 (SDLT)²</td>
<td>94,650</td>
<td>270m</td>
<td>2,853</td>
</tr>
<tr>
<td>2015-16 (LBTT)</td>
<td>104,520</td>
<td>201.9m</td>
<td>1,931</td>
</tr>
</tbody>
</table>

5. The first year of LBTT experienced a greater number of house sales, but lower revenue generation than 2013-2014. We may conclude that the majority of house buyers are paying less, or no, LBTT which has decreased income; with the higher end properties, who pay proportionately higher rates, not making up for the deficit.

6. With the £20m reduction block grant included in the 2015/16 results, the average still equates to an average tax of £2,123 per property.

¹ Statistics from HM Revenue and Customs UK Stamp Tax Statistics
² The SDLT slab structure was in operation from April 2014 to December 2014. The current SDLT structure used by the rest of the UK was in force in Scotland from December 2014 to March 2015.
7. This suggests a deficiency of the bands and thresholds within the residential framework of the tax.

8. The Registers of Scotland Quarterly House Statistics for April - June in 2013 - 2016 are outlined in the table below, and may shed light on this discrepancy:

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Sold House Price Value (£)</th>
<th>Tax Liable (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>164,326</td>
<td>386</td>
</tr>
<tr>
<td>2015</td>
<td>168,119</td>
<td>462</td>
</tr>
<tr>
<td>2014</td>
<td>162,122</td>
<td>1621</td>
</tr>
<tr>
<td>2013</td>
<td>153,025</td>
<td>1530</td>
</tr>
</tbody>
</table>

9. This indicates that the majority of sales are liable for a lower level of LBTT in comparison to SDLT, which explains the reduction on revenue generation via this tax.

10. Historically, RICS urged the Scottish Government to err on the side of caution when considering a significantly higher tax rate for Scottish properties at the higher end of house price spectrum. We felt that this would hurt revenue generation through this part of the housing market as foreign investors would look to invest elsewhere in the UK. This would put buyers and sellers of these properties at a disadvantage.

11. Furthermore, there is much evidence that indicates the Government’s objective to have LBTT assist the house-buying opportunity for first time buyers has been successful. The LBTT framework has increased house buying participation of FTBs and, therefore, activity at lower end of the housing market. Unfortunately, lower end properties do not contribute to LBTT revenue generation.

12. The Finance Committee, and Scottish Budget drafters, will have to consider: revenue generation via LBTT vs. assistance for market participants.

*The extent to which the rates and bands are consistent with the principles of “fairness, equity and the ability to pay”;

13. RICS believes that the progressive nature of LBTT, excluding 3% slab additional homes supplement (AHS), contributes toward the principles of “fairness, equity and the ability to pay”.

14. LBTT is applied on the marginal value of the property above the rate level, so whilst calculating LBTT is slightly more complex than that of the previous SDLT system, the progressive framework has all but eliminated house price peaks that were witnessed at band thresholds of the SDLT.

15. Referring to points 10 and 11 of this submission, there is an underlying view of LBTT - if a buyer can afford a higher end property, the buyer can afford a higher tax liability.
16. The evidence outlined in this submission, thus far, indicates that the LBTT regime performs its Government-set objective to help FTBs onto the housing ladder, and assist lower-end property buyers. However, the higher end buyer is not making up for the lost revenue through these assistance discretions.

17. The Finance Committee, and Scottish Budget drafters, will have to consider: revenue generation via LBTT vs. the principles of LBTT.

The impact of forestalling and whether it is likely to have a short-term impact only or lead to longer-term changes in the market;

18. The introduction of LBTT and Additional Home Supplement (AHS) resulted in surges in house sales in March 2015 and March 2016, respectively, evidencing the impact of forestalling. These surges were not unexpected and indicated in the RICS Residential Market Surveys in March 2015 and 2016, and evidenced through Registers of Scotland data.

19. In the main, the impact of forestalling is most likely a short term issue, assuming LBTT rates and thresholds remain the same going forward.

20. It is important to note that for the residential market, like all other markets, to operate effectively, it requires confidence, which is a product of consistency and stability.

21. The Scottish Government can influence consistency more than it can stability; for example, by providing a clear and coherent tax policy that remains in place long enough for a market to react and adapt to it.

22. By regularly changing financial policy and legislation, market confidence reduces and uncertainty increases – both of which have negative impacts on market sectors.

23. The Government has less influence over stability, as this is more susceptible to external market drivers and factors, such as global market activity, strength of currency and national elections.

24. Since LBTT was introduced, Scotland has experienced a UK General Election (May 2015), Scottish parliamentary election (May 2016), and the EU referendum and result (June 2016), weaker sterling and other global issues.

25. Before any national poll as there is usually a slowing of property transactions as potential home buyers or office occupiers delay their decisions until the result is announced. Market deceleration is not entirely unexpected, and this could have impacted LBTT revenue over the course of these events.
26. However, with control over the consistency element of market confidence, this Committee, and Scottish Budget drafters, need to consider: market confidence vs amended LBTT framework that leads to attainment of its principles.

The lack of available comparative data.

27. We have already discussed the need for stability and consistency in markets, but there have been a number of changes to the housing sector since the introduction of LBTT in April 2015 – not least the bands and thresholds, and introduction of AHS – but also additional elements like changes to the tenancy regime. This makes like-for-like annual comparisons complex, if at all possible.

28. In reviewing LBTT a balance has to be struck between amending the bands and thresholds to ensure they are still fair and relevant in assisting the sector, and creating a stable tax regime within which markets react and settle.

29. The Scottish Government has tendered for a research review of forecasting models of the housing market, to inform projections of residential LBTT in Scotland: Evidence Review: tax revenue forecasting models for the housing market

30. RICS understands that this research should provide an indication of potential amends to the LBTT bands and thresholds that should optimise receipts without having a detrimental effect, or over-reliance, on one particular price bracket of the market.

31. RICS recommends that the Scottish Government does not amend the bands and thresholds of residential LBTT until research report is returned, discussed with stakeholder and, if necessary, scrutinised by the Finance Committee.

32. It is important to get the framework right and let the market adapt and settle, as opposed to changing the LBTT framework in 2016/17, only to change it again the year after following the publication of this report.

Whether there should be any changes to the rates and bands in the draft budget for 2017-18;

New Exemptions

33. RICS believes there is scope for the Finance Committee to consider a number of exemptions from LBTT for certain buyers. If implemented, these changes need to be permanent to allow the market to react and adapt to the new setting.

Exemptions from the Additional Home Supplement (AHS)

34. It was prudent of the Cabinet Secretary for Finance, Constitution and Economy to match the UK supplement for second homes purchases as the Scottish housing market could’ve seen an influx of buy-to-let investors from England and Wales if a similar regime
was not introduced. The potential addition of house buying participants could increase competition and subsequently, potentially increased house prices, and then rents. This could’ve led to further unaffordability for first time buyers and, potentially, second steppers.

35. RICS in Scotland wants to see a PRS framework that encourages institutional investors to build and let new developments, not take on the landlord duties of current PRS stock.

36. There is, however, an argument to be made that small-scale buy-to-let investors assist the delivery of new large-scale developments.

37. It is often the case in large scale developments that new homes are built in batches, with the first tranche of sold properties supporting the commencement of second tranche construction. We can therefore presume that the faster selling of the first tranche would prompt an earlier start to development of the second tranche.

38. Buy-to-let investors, who buy properties within new developments, can make a contribution to house-building demand i.e. speeding up housing delivery and increasing supply, by purchasing these homes. However, in light of the AHS, some will be deterred from making these investments – keeping delivery at a slower pace, and potentially damaging supply of PRS accommodation, which is already low (evidenced by continuously increasing rents).

39. One possible approach to consider would be to exempt new build property from the AHS after all attempts to sell to owner-occupiers have been exhausted or after a set period of time.

40. We believe the Parliamentary Committee should also consider exemptions for an additional three types of development:

   a. Purpose-built holiday homes for rent

   Holiday homes provide benefit to tourism and local economies – particularly in rural Scotland, but can damage supply, leading to an increase in house prices, and reducing community infrastructure in a locality if there are too many.

   By exempting new build holiday homes, existing property supply should remain available, and be more affordable, to purchase for those wishing to remain in, or permanently move to, the locality. Simultaneously, holiday home investors wouldn’t be inhibited, nor development impaired.

   b. Purpose built student accommodation

   According to Savill’s, there was £6.5bn invested in student accommodation in the UK in 2015. This is a significant sum of money that reaps many rewards, such as increased
supply, job creation and less pressure on the PRS to house as students. Exempting this accommodation could ensure continued investment.

c. Purpose built for accommodation for private rent

It is universally accepted that the PRS is a significantly growing housing option in Scotland, and there is a need to assist supply. By exempting purpose-built property for let, investors (large and small scale) will be more enticed to invest and provide more homes to rent, which would serve to stabilise rent increases.

41. It is important to note here that these proposed exemptions are for new developments only, not existing stock.

42. This proposal could feasibly maintain adequate levels of investment in, and supply of, rented accommodation through sustained development, faster delivery and an increased supply. A likely outcome would be more created and maintained jobs and, ultimately, the stabilising of rent increases.

43. The Scottish Government will still gain LBTT receipts from these exempted properties (be it without an additional 3% of the price paid), but will also benefit from increased supply, job creation and improved local community infrastructure (rural).

44. In this instance, the Finance committee will need to consider: LBTT (and AHS) revenue generation vs housing delivery and supply.

Exemption or reduction for downsizers

45. The Scottish Government should consider an LBTT exemption or reduction for older owners wishing downsize. Looking to the dynamics of the property chain, in as much as a newly built residential property can trigger the sale of three, or more, properties, the same can apply to older people downsizing.

46. Whilst the Government may generate less tax revenue from older people purchasing their new, smaller home, the process of the property chain could benefit the public purse by up to three (or more) home purchases LBTT payments (assuming the price paid is liable to LBTT).

47. However, a predominant hindrance to those wishing to downsize is the tax on moving. The same can be said for property owners who have deduced that it would be cheaper to extend or improve their existing property than move to a larger, better maintained or more energy efficient dwelling.

48. Indeed, anecdotally, there was a period of adjustment at the higher-end of the market as individuals weighed the options of the increased cost of moving, against improving their present dwelling.
49. RICS professionals’ sentiment advised that people in medium sized and priced homes (and above) are less inclined to move at present due to the costs incurred for moving. As an alternative, they are building extensions or improving their existing property which is hampering new homes coming to market.

50. Furthermore, there is a link between medium to higher end properties not coming to market, and improvement works being undertaken to properties; the consequences being ‘improve, not move’ and a housing market that lacks dynamism.

51. Whilst improvement works will benefit the local labour force and the accompanying economic benefits, the Government generates less, direct revenue and fewer homes come to market – augmenting issues over supply.

52. This Committee, and Scottish Budget drafters, have to consider a preferred method of revenue generation: revenue through LBTT, or revenue through income tax and VAT receipts.

53. In a worst case scenario, a growing family in need to upsize is not able to do so due lack of supply and the costs of moving, and are not in a position to extend their property due the costs to make improvements. They find themselves locked in an unsuitable property in a static market.

54. To tackle this conundrum, the Committee, and Scottish Budget drafters, have to consider: housing market activity (across all prices) vs. the principles of LBTT.

**Final markets**

55. The Finance Committee need to consider what is a “good” housing market? Whether it is one that:

   i. Is fair, based on ability to pay; or generates revenue for Government?
   ii. Assists a specific area of the house price spectrum; or across all the house prices?
   iii. Encourages new development, or suppresses the pace of housing delivery?
   iv. Enhances house buyer mobility, or boosts home improvements?