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STATES GREFFE

4th February 2009.

Senator Sarah G. Ferguson,
Chairman,
Corporate Services Scrutiny Panel
Morier House,
St. Helier. JE1 1DD.

Review of Draft Income Tax (Amendment no: 32) (Jersey) Law.

Looking at your Panel's terms of reference, I do not believe the proposal is either appropriate or fit for purpose and the consultation process was neither robust nor complete, when neither the Advocates nor the Chartered Surveyors were circulated in 2008.

This will be the third time that I have had to try and explain the case for the retention of Article 115(g). I will leave it to others to raise the issues that relate to taxing deemed rental values; suffice it to say that I can see how seductive and politically acceptable it may appear to be – which only makes it more acute that it receives complete scrutiny. What follows is substantially the same as my letter to Senator Le Sueur in June 2006.

By way of background/introduction, when I was one of the first directors of the Waterfront Enterprise Board, I initiated the proposal that resulted in the change to the definition of "corpus fundi" that now enables funding for development to take place on land that is the subject of a long lease. Thus the States avoided having to sell the freeholds, which might have been politically unacceptable, whilst still being able to attract long-term funding from institutional investors, including pension funds.

I have been involved in commercial property development and investment since the 1970's. As a director of the Fox Group, I have been involved in three major office developments on the Esplanade – Citibank House was built on the site of Fox's former warehouse, Sir Walter Raleigh House, the granite building next to Marina Court and, next door to that, the Carey Olsen/KPMG building. I also developed International House, the former Abbey National HQ opposite the Town Hall and redeveloped the former Coca Cola building on Rue des Pres, where Fox's are currently situated. All these buildings were constructed to (UK) "institutional" specifications and were designed to appeal to UK funds for their pension fund portfolios. This was crucial to supporting the valuation of the prospective completed value of the scheme that, in turn, gave our bankers the confidence to provide the interim development finance.

Early in 2006, Fox's decided that it was an appropriate time to sell our interest in Sir Walter Raleigh House and, following a limited tender in April, selected a purchaser acting for and on behalf of The Universities Superannuation Scheme Ltd. Given that we had three other bids from Channel Island entities at the same sort of level, we felt that it was in the best interests of the Island that a fund that had no other investments in Jersey should take a stake in our market, potentially increasing much needed liquidity. I understand that they had indicated they were interested in acquiring other investments in the island as well.

After two months of investigation and due diligence by the purchaser, and with completion scheduled for two days away, they received advice from Ernst and Young that they might not be able to receive the rent gross in the future. They immediately withdrew from the transaction.

That the repeal of Article 115 is included in the Draft Law, after my previous representations from 2006 to 2008 still leads me to have serious doubts about whether the potential unintended economic consequences have been considered, understood and taken into account. I have yet to see or hear any convincing argument from the proponents of the proposal.

The effect of reducing the rental income by 20% will have two immediate consequences:

- A reduction in capital values of completed developments and current standing investments. In our case their revised offer was 9.5% below the previously agreed price,

- Consequently, there will be a considerable negative effect on the underlying site/land values, given that all the other costs of building remain the same.

The lack of the additional liquidity coming from the institutional investors, owing to their potential ability to fund large buildings with high end values, will restrict the ability of the market to create modern, high specification office buildings with large floor plates. The consequence of that will be stagnation, unless rents rise to compensate, adding to the finance industry's costs, and a loss of revenues to the States from:

- ✘ The reduction in land values on the waterfront, in particular,
- ✘ Loss of stamp duty receipts from land sales and sales of completed investments,
- ✘ Loss of revenues and job losses throughout the property sector amongst building contractors and developers and their architects, quantity surveyors, structural engineers, letting agents and surveyors and accountants, lawyers, et al,
- ✘ A reduction in activity amongst the freight companies and the port,
- ✘ Potential for bad debts amongst the local banks from a reduction in capital values, leading to over-exposure to the sector and adjustment of lending portfolios to compensate for the increased risk, resulting in increased financing costs, assuming finance is available at all, and a further reduction to land values.

I have set out below the assumptions I have used in demonstrating the effects on an imaginary 60,000 square foot office building providing floor plates of 10,000 sq ft gross. The actual numbers used may not be entirely accurate but the same have been used for both examples, with and without a deduction of tax. Residual appraisals are notoriously sensitive to small changes in the assumptions used. However, the net effect on the land value is a reduction of £2,400,000 to the freeholder of the site.

Residual Development Appraisal in June 2006 numbers:

60,000 square foot office building.
Basement and five upper floors, lettable area 41,250 sq. ft.
Rent £27.50
Capitalisation Yield 7.00%
Sale Costs 5.00%
Developer's Profit 15.00% This assumes a pre-let.
Building Costs: Car Park £100.00, Offices £145.00.
Professional fees, including project management, fund's supervision fees and decennial insurance 16.5%
Letting Fees 10.0%
Sale Fees 1.5%

Legals 0.5%
Interest at 4.5% + 2.0%. 6 month's void/rent free allowed.

Residual Site Value with tax on income at 20.0%	(£437.000)
Residual Site Value with no deduction for tax	£1,962,000.
Difference in land value	£2,400,000.
Per square foot of gross developable area	£40.00.

As far as the waterfront and elsewhere is concerned, this, of course, relates to land owned by the Public of the Island.

The philosophy behind the proposal still seems to fly in the face of everything that the States is trying to achieve to promote business and commercial activity. In addition, we now face a crisis for the construction industry. I hope that the proposal to tax property rentals payable to UK funds and superannuation schemes can be relegated to history permanently and with some urgency. I am afraid that we are taking an unnecessary risk for unknown and unquantifiable benefits at a time that we do not need to.

I note that a Jersey Pension Fund will, currently, suffer a UK deduction for tax under the Non Resident Landlord scheme. I doubt that there are any Jersey Pension Funds that are sufficiently substantial to hold direct property investments in their portfolios. It is, perhaps, a hollow justification for repealing Article 115, as is the view that non resident companies will move their Jersey property holdings into pension schemes to avoid the tax.

I would urge you not to accept the over-worked phrase "Well they would say that, wouldn't they..." that seems to have taken the place of "well there is always a boat in the morning". I have tried to inform the debate through conversations with Dougie Peedle, who was asked to look at this by Senator Le Sueur, together with an offer made at the end of last year when Richard Lock and I met with Senator Le Sueur and Deputy Ryan to try and explain the mechanics of development appraisal, as outlined above. There has been no reaction to that offer – part of the reason that I do not view the consultation process as robust, let alone informed or complete!

Yours sincerely,

Jock C. Russell