

The Impact on the Self-Catering Sector of the Proposed Changes to Furnished Holiday Lettings Rules

Executive Summary

- The Chancellor announced in the 2009 Budget that, from April 2010, the Furnished Holiday Lettings (FHL) rules will be repealed. As a result of the proposed changes, operators of self-catering accommodation will face a greater tax liability which will severely affect the viability of their business.
- There was no prior consultation about the scrapping of the rules with those involved in the tourism industry in general, and the self-catering sector, in particular.
- The analysis presented in this brief suggests that if just 10% of businesses decide to cease trading as a result of the repeal of the FHL rules, tourism expenditure will decrease by almost £110m per annum and over 2,400 jobs will be lost.
- When the impact on Holiday Parks is included, the potential overall impact is a reduction of over £200m in tourism spend and the loss of over 4,500 jobs in rural and seaside economies – substantially greater than the Treasury estimate of a £20m impact.
- The majority of these job losses would occur in the South West, Scotland, Wales and the North West.
- We are therefore calling upon the Treasury to undertake a review to fully evaluate the economic impact of repealing the FHL rules so that the consequences of this policy can be fully understood and measures introduced to mitigate against the negative impacts. Considering the impact on tourism, rural areas and regional economies, it is important that input to this review is provided by DCMS and DEFRA, and their colleagues in Scotland and Wales, as well as the Industry.

1. Introduction

The Furnished Holiday Lettings (FHL) rules currently allow owners of self-catering cottages in the UK, as long as they satisfy certain tests, to be treated as trading businesses for tax purposes. However, as UK owners of similar properties elsewhere in the EU cannot qualify for this treatment, the Government has determined that the FHL Rules may not be compliant with European law and, as part of the 2009 Budget, announced their repeal from April 2010. We are advised the main fiscal consequences of the repeal of the FHL rules would be:

1. Losses from FHLs would not be able to be set against other income (eg., other trading or employment income).
2. Capital Allowances would not be available.
3. Income from FHL would no longer be 'relevant earnings' for pension purposes (which could affect those who have no other trading or employment income).
4. The sale of the FHL business would no longer be eligible for the following capital gains tax reliefs:
 - a. entrepreneurs's relief (which reduces the taxable gains on the sale of a business); and
 - b. roll-over relief (which allows gains arising on the sale of business assets to be deferred if the proceeds of sale are reinvested into other business assets); and
 - c. specific hold-over relief for business assets (which allows the accrued gains arising on a lifetime gift of property to another individual to be deferred and assumed by the donee).

The Treasury contends that there are 60,000 self-catering properties affected by the change and the impact on these businesses would be 'only' £20 million per annum.

However, the Tourism Alliance believes that the Treasury analysis seriously under-estimates the potential impact of repealing the FHL Rules on both the self-catering sector and the rural and seaside communities in which most self-catering businesses are located.

This paper therefore sets out to determine the volume and value of this sector and to model the impact that repealing the FHL Rules could have on businesses and employment in local communities. This analysis is based upon data from the 2008 UK Tourism Survey and an analysis of the accounts of 218 self-catering businesses undertaken by an accountancy firm which specialises in this sector.

It should be noted that this analysis applies only to the traditional "holiday cottage" component of the Self-Catering sector. A separate analysis of the Holiday Parks component, which is also potentially significantly impacted by the proposed repeal of the FHL Rules, has been undertaken by the British Holiday and Home Park Association (BH&HPA).

2. Volume and Value of the Self-Catering Sector

According to the latest UK Tourism Survey (UKTS) statistics, the domestic tourism industry was worth £21.1 billion to the UK economy in 2008. Despite the economic downturn experienced during the year, the revenue gained by the sector was down only 1% on 2007.

A conservative analysis of the UKTS figures (ie., excluding self-catering associated with holiday villages, hire boats and timeshare properties), indicates that the “holiday cottage” component of the sector accounts for 5.72 million visits (4.9%) and £1.823 million (8.6%) of total UK domestic tourism expenditure with an average expenditure of £55.21 per person per day.

When travel purely for holidays is separated out from business travel and travel to see friends and relatives, the importance of self catering cottages is more marked, accounting for 7.6% of all holiday visits, 12.4% of all nights and 12.9% of all revenue.

In addition, the separate BH&HPA analysis of static caravans and holiday parks indicates that caravan holiday homes account for a further 8% of all tourist bednights in the UK and £1.136bn in domestic tourism expenditure, giving a total level of expenditure potentially affected by the change of almost £2bn per annum.

The Size of the UK Self-Catering Industry

	Trips (m)	Nights (m)	Spend (£m)	
Total UK Domestic Tourism	117.71	378.39	21,107	
Total UK Holiday	75.43	266.93	14,098	
Self Catering				Percentage
Total UK	5.72	33.02	1,823	
Northern Ireland	0.07	0.26	18	1.0
England	4.23	23.47	1,323	72.6
Scotland	0.83	6.18	302	16.6
Wales	0.6	3.11	180	9.9
West Midlands	0.07	0.3	14	0.8
East of England	0.39	1.87	97	5.3
East Midlands	0.39	1.76	103	5.6
London	0.07	0.37	27	1.5
North West	0.66	3.13	212	11.7
North East	0.18	1.12	55	3.0
South East	0.32	1.49	121	6.7
South West	1.74	11.15	574	31.5
Yorkshire	0.38	2.06	106	5.8

As can be seen from the table above, the holiday cottage sector of the self-catering industry is relatively evenly spread throughout Wales, Scotland and the regions of England with most areas having 5% - 10% of the total expenditure associated with self catering. The main exceptions are Scotland (16.6%) and the South West which, as a prime holiday destination with few cities, accounts for over 30% of all self-catering expenditure in the UK.

At the other end of the spectrum, the metropolitan regions of London and the West Midlands collectively account for just over 2% of self-catering accommodation, indicating that this form of accommodation is highly concentrated in rural and seaside areas.

3. Importance of Self-Catering Sector to Regional Economies

To further quantify the importance of self-catering accommodation to regional economies, an analysis was undertaken of expenditure on holiday cottage accommodation regional as a percentage of total tourism expenditure both regionally and nationally.

Self-Catering as a Percentage of Total Tourism Expenditure

	Total Domestic Spend (£m)	Self Catering Spend (£m)	Percentage
UK	21,107	1,823	8.6
Northern Ireland	450	18	4.0
England	16.433	1.323	8.1
Scotland	2.812	302	10.7
Wales	1.411	180	12.8
West Midlands	1.149	14	1.2
East of England	1.362	97	7.1
East Midlands	1.60	103	9.7
London	2.356	27	1.1
North West	2.338	212	9.1
North East	697	55	7.9
South East	2.350	121	5.1
South West	3.639	574	15.8
Yorkshire	1.397	106	7.6

As stated above, this component of the self-catering industry accounts for 8.6% of all tourism expenditure in the UK. Therefore, the regions with a significantly higher than average dependence on this sector are Scotland, Wales and the South West, where the sector accounts for, respectively, 10.7%, 12.8% and 15.8% of all domestic tourism receipts.

That the repeal of the FHL Rules would differentially impact upon rural and seaside economies rather than urban areas is underlined when expenditure associated with self-catering accommodation is assessed on the basis of destination type rather than region.

The following table shows that just over 70% of expenditure associated with self catering (over £1.2 billion per annum) occurs in seaside and rural locations. If small towns are included, the proportion of businesses located outside large towns and cities increases to 88% (£1.54 billion per annum).

Expenditure by Destination Type

Destination Type	Spend (£m)	Percentage
Seaside	598.2	39.6
Large city/ large town	285.7	12.0
Small town	306.9	17.3
Countryside/ village	632.1	31.1

4. The Number of Affected Businesses

The next task is to determine the number of businesses in the self-catering sector that would be affected by the repeal of the FHL Rules.

This can be done by taking the number of nights spent using self catering (33 million per annum) and multiplying it by the average expenditure per night on accommodation (£21.33 – this is based on an average cost of a self-catering unit of £80 per night and an average occupancy of 3.75 people). This gives the total annual revenue spent on self-catering accommodation in the UK as £704 million.

To convert this into the number of holiday cottage businesses in the self-catering sector, a survey of 218 businesses was undertaken by a specialist accountancy firm in the sector. The turnover of the average self-catering business that employed this firm was £17,347 per annum. Dividing the total expenditure by this figure gives an estimate of 40,602 businesses in this sector.

Again, it should be noted that the estimate of self-catering businesses is conservative as the businesses that use an accountancy firm will be larger than the average and tend to operate multiple rental units.

Self Catering Businesses by Location

	Spend on Accommodation (£m)	Number of Self Catering Businesses
UK	704	40,602
Northern Ireland	6	320
England	501	28,859
Scotland	132	7,599
Wales	66	3,824
West Midlands	6	369
East of England	40	2,299
East Midlands	38	2,164
London	8	455
North West	67	3,849
North East	24	1,377
South East	32	1,832
South West	238	13,710
Yorkshire	44	2,533

The BH&HPA analysis of the Holiday Park sector indicates that there are a further 570 holiday park businesses and 83,000 private individuals operating a static caravan as a self-catering business who would be affected by the change. This gives a total of over 123,000 businesses potentially affected by the change.

5. Employment in the Self-Catering Sector

Using the figures for expenditure on accommodation, and the figures for expenditure on other products and services, estimates of the number of jobs associated with self-catering businesses can be generated using a 2003 study on tourism employment by VisitBritain.

This study, *Employment Generated by Tourism in Britain*, found that average turnover required to generate an additional Full Time Equivalent (FTE) tourism job outside London was £39,500: taking account for inflation since 2003, this figure increases to about £45,000. Applying this figure to expenditure on holiday cottage related holidays gives the following estimates of employment associated with this sector of the self-catering industry.

Employment Associated with Self-Catering Holidays

	Spend on Accommodation (£m)	Employment in sector	Spend in community (£m)	Other local Employment
UK	704	15,651	1,118	24,853
Northern Ireland	6	123	12	275
England	501	11,125	822	18,268
Scotland	132	2,929	170	3,788
Wales	66	1,474	113	2,522
West Midlands	6	142	7	164
East of England	40	886	57	1,275
East Midlands	38	834	65	1,448
London	8	175	19	418
North West	67	1,484	146	3,235
North East	24	531	31	695
South East	32	706	90	1,992
South West	238	5,285	336	7,473
Yorkshire	44	976	62	1,381
TOTAL EMPLOYMENT	40,504			

As can be seen from this table, there are over 15,600 FTE jobs directly related to this type of self-catering business and visitors to these premises spend a further £1.1 billion in local businesses such as restaurants, attractions, pubs and shops. This secondary expenditure accounts for a further 24,800 jobs, giving a total of over 40,000 jobs dependent on this sector – over 70% of which (over 28,600) are located in rural and seaside areas.

It is important to note that the majority of the employment associated with expenditure on this form of accommodation is related to local services and trades people rather than the owners of self-catering properties.

As can be seen in the table below, the accountancy firm's analysis of 218 businesses shows that they generated combined revenues of £4.2 million last year. Of this, £2.25 million (53%) was spent employing local tradespeople and cleaners, while a further 19% was spent on furnishings, the majority of which would be bought from local shops.

Therefore, with most owners of self-catering premises live within 5 miles of the property, it can be seen that the vast majority of expenditure generated by self-catering properties stays within local communities and does not accrue to owners who live in cities.

Expenditure on Local Services and Goods

Total Revenue (£000)	Repairs (£000)	Cleaners (£000)	Refurbishment (£000)	Furnishing (£000)	Expenditure in Local Community (£000)
4.200	600	350	1.300	780	3.030

Based on a sample of 218 businesses

6. Impact of FHL Rule Changes on Regional Economies

Having determined that the holiday cottage sector of self catering is a large and important component of the UK domestic holiday industry, employing over 40,000 people in mostly rural and seaside areas, the final step is to calculate the potential impact of the repealing of the FHL rules on regional economies.

To answer this, the accountancy firm's analysis of the accounts of the 218 businesses was used to determine the impact that repealing the rules would have on the profitability of businesses. This analysis showed that the collective profit from the 218 businesses before interest payments was just £830,000 - an average of £3,800 per business. This indicates that self-catering businesses operate on marginal profitability.

The low level of profitability and the very high level of expenditure on the maintenance of self-catering properties noted previously indicate that a change to the tax treatment of these properties would have a significant impact on their viability.

The accountant's analysis of these companies' accounts concluded that the impact of repealing the FHL rules would be to reduce the profit of these businesses by an average of £1,307. Multiplying this figure by the estimated number of holiday cottage businesses in the UK (40,600) gives a cost of £53 million per annum, significantly higher than the Treasury estimate of £20 million.

This figure also means that the average profit of these businesses would be reduced by 34% from £3,800 to £2,493 per annum. While there is no way of knowing the impact that this drop in profitability would have on self-catering businesses, it is reasonable to assume that a percentage of operators would decide that it is no longer worthwhile to operate their business and withdraw their properties from the market.

While some of these properties would be sold to permanent residents, the majority would revert to use as second homes. As such, the level of use of the property would fall from the average 23 weeks per year under self-catering operation. As a result, the level of revenue spent in the local economy would also fall significantly.

In addition, the level of expenditure per day of use will decrease as expenditure on local trades people and cleaners would fall (commercial properties require greater levels of maintenance than private properties) and secondary expenditure in the local community would be lower as the owners of secondary homes spend less on local attractions and facilities than tourists (eg. an owner may visit an attraction once a year while each new set of visitors to a self-catering establishment will visit the attraction).

Therefore, it is estimated that converting a self-catering property to a second home will reduce revenue to the local economy by 60%. This is probably a conservative estimate as the BH&HPA analysis of revenue generated by a self-catering static caravan shows that there is an almost 70% reduction of expenditure in the local economy when a the use of a static caravan switches from self-catering business to second home.

While the impact of the change of FHL rules on capacity in the holiday cottage sector is difficult to determine, estimates of a reduction of between 5% and 15% seem reasonable based on the 34% reduction in profitability.

Using this range, the impact of the change in terms of revenue and employment in local economies is estimated to be as follows;

Impact of Reduced Capacity in the Self-Catering Sector

Decline in Capacity	Reduction in Businesses	Reduction in Revenue to Local Economy (£m)	Reduction in jobs in Local Economy
5%	2,030	£54.7	1,215
10%	4,060	£109.4	2,431
15%	6,090	£164.1	3,645

Finally, an analysis was undertaken to provide an indication of where in the UK the reduction of capacity would have the greatest impact. The following table indicates that, as expected, the regions that are most dependent upon self-catering would be the most severely impacted with the South West particularly badly affected with up to 1,148 jobs likely to be lost if there is a 15% drop in the number of holiday cottages available.

Impact on Jobs of Reduced Capacity by Region

	5% Reduction	10% Reduction	15% Reduction
UK	1,215	2,431	3,645
Northern Ireland	12	24	36
England	882	1,764	2,645
Scotland	201	403	604
Wales	120	240	360
West Midlands	9	18	28
East of England	65	130	195
East Midlands	68	137	205
London	18	36	53
North West	142	283	425
North East	37	74	110
South East	81	162	243
South West	383	766	1,148
Yorkshire	71	141	212

7. Conclusion

This paper highlights the potentially damaging impact that the proposed repeal of the FHL rules on the country's self-catering sector, in terms of a stark reduction in profitability leading to significant job losses in areas of the country already badly affected by the recession.

The analysis in this paper suggests that if just 10% of businesses decide to cease trading as a result of the repeal of the FHL rules, tourism expenditure

would decrease by almost £110m per annum and over 2,400 jobs would be lost. When BH&HPA's analysis of the impact on Holiday Parks is included, the overall impact is a reduction of over £200m in tourism spend and the loss of over 4,500 jobs in rural and seaside economies – substantially greater than the Treasury estimate of a £20m impact.

This comes at a time when the Government should be doing everything possible to protect jobs and support the rural economy.

As Shaun Spiers, the Chief Executive of the Campaign to Protect Rural England has said of the proposed changes: “Any measures that could damage sustainable economic activity in rural areas during these recessionary times need to very closely looked at”.

We, therefore, call upon the Treasury, as a matter of urgency, to enter into a meaningful consultation with the industry and officials from affected departments such as DCMS, DEFRA and their counterparts in Scotland and Wales, to determine the true impact of the proposed repealing of the FHL Rules. We are confident that solution can be identified that will comply with EU requirements and protect tax revenue without negative consequences on rural and seaside tourism economies.

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