

All Party Parliamentary Beer Group Inquiry – Unlocking Pubs’ Potential



The British Beer & Pub Association is the UK's leading organisation representing the brewing and pub sector.

We represent companies in the UK which between them own around 20,000 pubs and brew over 90% of beer sold in the UK. Member companies have many different ownership structures, including UK PLCs, privately-owned companies, independent family-owned brewers and UK divisions of international brewers.

Introduction

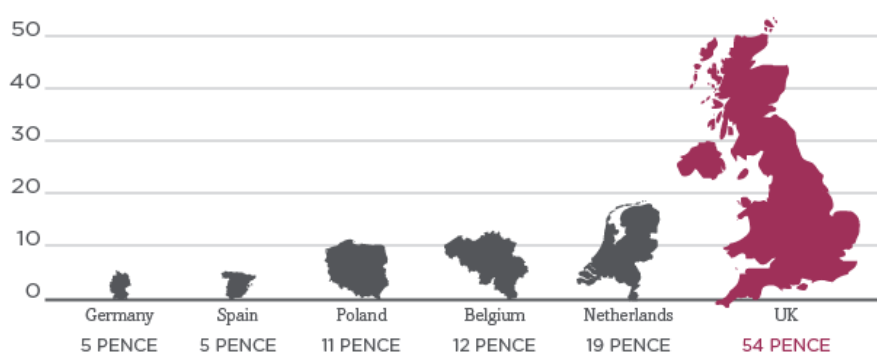
Over 80% of Britain's 48,000 pubs are run as individual SMEs and they are facing some major challenges. A disproportionate tax burden means that one in every three pounds spent in the pub goes to the taxman. This amounts to an average of £140,000 per pub each year. This is alongside sharply rising regulatory costs for labour-intensive businesses such as pubs, (for example the National Living Wage, pension auto-enrolment and the apprenticeship levy), as well as increasing competition for the leisure pound and an ageing population. Pubs also face an acute shortage of pub chefs and kitchen staff at a time when a quality food offer is becoming critical for pubs to thrive. This submission aims to summarise some of the key issues facing pubs today, and what can be done to help them.

Section One: Beer duty and pubs

Beer and pubs are inextricably linked – seven of every ten alcoholic drinks sold in a pub are beers, but British beer sits under an onerous tax burden. The beer duty freezes in late 2017 and 2018 were a welcome measure after the damaging 3.9% increase in March of 2017 which cost £130 million and since most pubs are small businesses, they had no choice but to pass on the increase cost to consumer, which in turn affects footfall. Modest cuts and freezes in beer duty between 2013 and 2016 recognised the economic and social importance of beer and pubs and secured over **20,000 vital jobs**. This meant money back in the pockets of consumers and also led to much needed new investment in pubs. It also coincided with beer sales overall increasing in 2018 by 2.6% - the biggest year-on-year increase in 45 years (also helped by good weather and World Cup). This followed the Beer Duty Escalator period of crippling increases of over 42% between 2008-2012 which contributed to thousands of pub closures, job losses and diminishing returns for Government.

However British beer remains overtaxed. Britons pay nearly **40% of all the beer duty paid in EU nations**, but only consume 12% of the beer. The beer duty rate in Germany is **eleven times lower** than the UK rate.

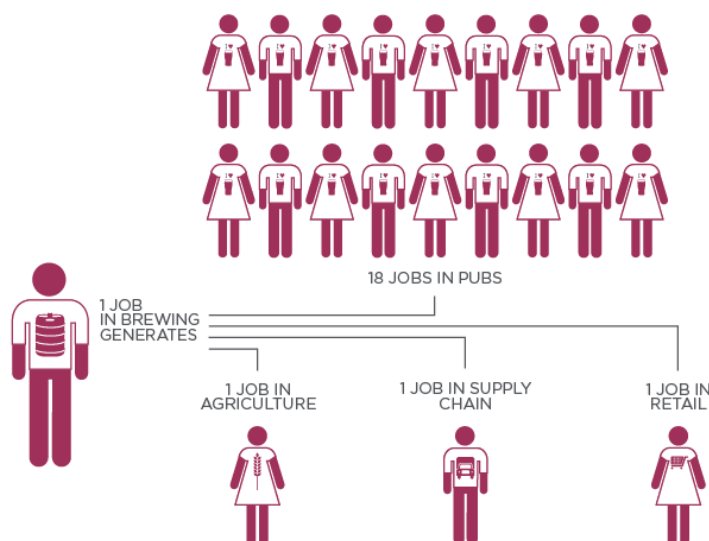
BEER DUTY RATES IN TOP SIX EU BREWING NATIONS
(PENNY PER PINT OF 5% ABV BEER)



This imbalance is set to get worse with the Treasury including in the public finances planned **RPI increases** to beer duty of **13.1%** in the next four years, putting new investment in British brewing and pubs at huge risk. Using the discredited RPI inflation measure (rather than CPI) alone could **add £390m** to the costs to consumers over this period. Brewing and pubs in the UK supports almost **900,000 jobs**, and 43% of those employed in the sector are under the age of 25. When beer tax goes up, consumers vote with their feet and footfall decreases. Beer is a job creator, **one job in brewing creates 21 jobs** elsewhere in the economy.

Cutting and freezing beer duty protects jobs in this vital UK manufacturing sector – 80% of the beer consumed in the UK is brewed here as well.

HOW BEER CREATES JOBS



Beer is also one of the UK's top food and drink export products. The most recent figures available suggest that Britain's brewers exported over 155 million pints to the USA, and trade with EU nations was worth over £205m to the UK economy. British beer is also expanding into emerging markets as well, export growth to China is thirteen times larger than it was in 2015, and since 2009 exports to South America have grown by over 80%.

Small Brewers Relief

We were encouraged by the Chancellor's announcement at the 2018 Budget that the Small Brewers Relief (SBR) scheme would be reviewed. The scheme is long overdue a review, having operated unchanged for almost two decades. The brewing sector has changed beyond recognition in that time and inevitably SBR has created something of a "squeezed middle" between the tax breaks of small producers and the economies of scale available to much larger brewers. A number of breweries in recent years have sought to downscale their brewing because of this, and there are very recent examples of established family brewers exiting the industry altogether citing the pressures created by SBR. A vibrant and healthy brewing sector is vital for pubs, where 7 out of 10 beers sold are beer and over ninety per cent is draught beer. Cask-conditioned ale is a unique selling point of British pubs.

What do we want to see?

A modest cut in beer duty at the next Budget would create thousands of additional jobs, boost inward investment, tourism and export growth, and ensure a pint in the pub remains an affordable pleasure, bringing together people from all walks of life. This call was supported by over 115,000 people who signed the Long Live the Local campaign in 2018 – almost 50,000 of whom contacted their MP to express their support in 2018.

There is also an opportunity for the Government to support beer as the lowest strength alcoholic beverage available with the widest range of no- and low-alcohol alternatives by increasing the threshold defining lower-strength beer that qualifies for duty relief. This level is currently at 2.8% ABV, but we believe this should be

moved to 3.5%. Such a move would stimulate further investment in lower-alcohol products. This increase in the threshold is currently part of proposed revisions to the EU Directive that governs alcohol duty structures. Once the UK has left the European Union, we believe there is potential to look more fundamentally at how beer is treated from an excise perspective. The BBPA has publicly called for a more competitive excise duty regime that supports growth in exports of British beer, encourages the consumption of lower-strength drinks and supports pubs. Australia again provides an interesting case study here as it operates a reduced rate for draught beer as well as lower-strength beers. Oxford Economics have also done some initial modelling considering a discounted rate for draught beer. This confirms that this would provide a significant boost for pub's share of the market and an associated increase in employment. However, any such measures need to be considered alongside continued action to address the overall beer duty rate which remains the main concern for brewers.

The BBPA supports SBR and a structure that builds on the success of the existing system that has contributed to approaching 2000 new brewers entering the market. We have always contended however, that the current structure and level of relief would create significant economic distortions in the market. All the evidence since 2002 has borne this out. It is vital now to address this and to move towards a level playing field that encourages brewers of all sizes to grow and is more akin to SBR schemes elsewhere in Europe.

We welcome that the Government remain committed to SBR. The parameters of the review also set out that that SBR should not discourage growth, should minimise distortions and any changes be fiscally neutral. On this basis, we would urge the following changes:

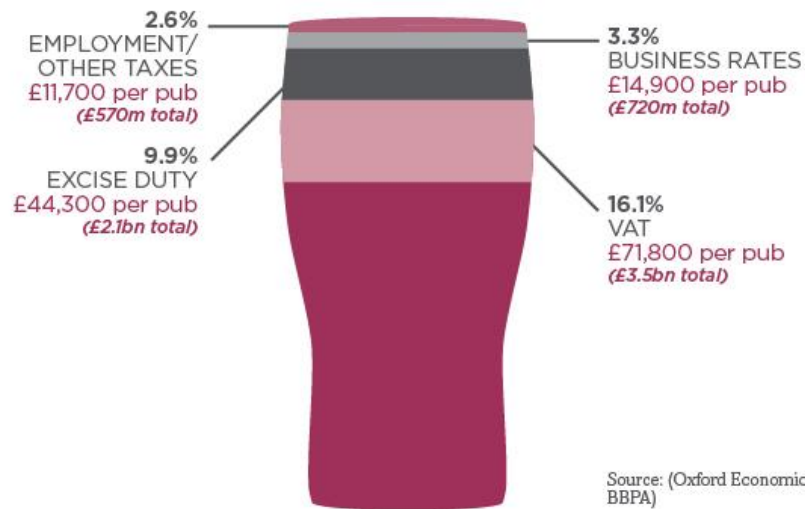
SBR should be converted to a cash value, rather than calculated as a percentage of main duty rate. The shape of the relief curve should more closely reflect the economies of scale in brewing (which start below 5,000 hl and increase beyond 60,000 hls) and any changes should be phased over time to minimise distortions. Consideration should also be given on how to address unintended consequences of disincentivising exports at certain production levels and in M&A activity. A cash cap regardless of ABV would also be a way to further incentivise the production of lower-strength beers.

Section Two: The Business Rates Burden on Pubs

The business rates burden is crippling for many pubs. Pubs pay 2.8% of the total rates bill yet represent only 0.5% of rate-paying businesses turnover, an overpayment relative to turnover of £500 million. Per pound of turnover, pubs pay more in rates than any other business sector¹. A legacy of very different times, there can be no justification for such an inherent unfairness in light of today's increasingly digital economy. The 2017 business rates revaluation compounded this issue, with many pubs facing further very significant increases.

¹ On average a pubs rates bill equates to c.4% of turnover. This compares to 2% for supermarkets/shops and 1% or less for most business sectors

ONE IN THREE POUNDS SPENT IN PUBS GOES TO THE TAXMAN



The two-year business rates discount of a third of the total bill (for pubs and other retail businesses with a rateable value of less than £51,000) announced at the Autumn Budget was extremely welcome. This is worth up to £8,000 for qualifying pubs and replaces the £1,000 pub-specific relief introduced in 2017/18. In both instances, the number of pubs that benefit is constrained by State Aid rules and larger pubs also continue to bear a disproportionate rates burden. We estimate that only 19,000 of the nation's 48,000 pubs will qualify.

The move to more frequent revaluations and revaluation using CPI rather than RPI is also welcome. However, CPI only slows the rate of increase – it still presents upward pressure on the multiplier. The multiplier used to calculate the bill for individual businesses has increased by 38% in real terms since its introduction in 1990. So in other words for an individual pub (before any reliefs), their rates bill is calculated at 49% of their rateable value (49p in the pound) compared to c.35p in the pound in 1990. So whilst business rates used to be about third of rents they are now about half.

What do we want to see?

We would like to see the Government commit to its manifesto promise of a wholesale review of business rates to address the rapidly evolving nature of business – and particularly the move to online goods and services reflecting the growth of on-line businesses and ensuring on-line businesses pay a fairer share of the business tax burden. The Digital Services Tax announced in the Budget was a positive step, but the additional projected revenue from this (around £400m by 2022-23) will not in itself be anywhere near enough to reduce significantly the £31bn business rates burden for property-based businesses, even it were to be used towards this.

In the immediate term we also believe the following measures would demonstrate critical support for the sector:

i. Investment relief

Investment is the lifeblood of pubs which need to evolve to meet changing consumer demand. Pubs are almost uniquely valued on the basis of turnover and this can be a significant disincentive to investment. Investment in pubs will almost certainly lead to an immediate revaluation based on a presumption of increased turnover. In some instances, increases can even be backdated. However, any increased profitability and return on investment will inevitably be realised over a longer period. This was recognised in the recent Barclay Review in Scotland and the recommendation, accepted by the Scottish Government, of at least a 12-month period before any increase in business rates following an investment.

We would like to see this applied to pubs throughout the UK and extended so there is no revaluation of a pub premises on the back of investment for the longer of two years or until the following revaluation period. This would complement the additional business investment incentives announced in the Autumn Budget.

ii. Community Services Relief/Adjustment

Pubs are the original social network and, by their nature, inefficient users of space. They provide a comfortable and welcoming environment and often provide free use of this space for local clubs to meet, run sports teams and charitable events at their own expense and act as tourism information points.

Through Pub is the Hub and other schemes this may be taken to the next level in terms of providing post-office services, a library, parcel collection, tourist information among others. Indeed, many pubs are listed as Assets of Community Value.

We believe there should be a relief or an adjustment to a pubs rateable value to pubs that can demonstrate they provide additional community services beyond running their business. The criteria would be agreed with Government along with the level of relief/adjustment to reflect the level of community service provided.

iii. Overtrading and fair maintainable trade (FMT)

The turnover on which pubs are rated is based on an assessment of fair maintainable trade (FMT) that is deemed achieved by a reasonably efficient operator.

The 2017 valuation guidance includes a section on how to deal with this but, in reality, the default position continues to be based on the latest annual accounts of actual turnover. Therefore, when a high-achieving operator takes an average pub and transforms this they are often heavily, and unfairly, penalised in terms of a large increase in business rates. It is vital pubs are rating on an FMT rather than simply on latest turnover data as set out in the guide.

We would urge greater investment and training in pub-specific valuation officers. Furthermore, we welcome collaboration with the Valuation Office Agency, and we will continue to work with the VOA and Government to ensure that the 2021 Guide to the Valuation of Public Houses reflects our concerns. As well as the issue of overtrading, pubs may often be placed in a higher rating band and/or incorrect category resulting in higher bills than should be the case

iv. Extending pub-specific relief

Until wider reform, which must ultimately reduce the business rates multiplier or result in an alternatives to rates itself, the system must continue to recognise the disproportionate burden faced by pubs and to seek to mitigate for this. Current reliefs are constrained by State Aid rules. This seems unreasonable in a situation where the tax is levied on individual pubs and a way to overcome this found.

One-third of bills for all pubs on the their first £51,000 of RV or a separate multiplier of pubs have been suggested by way of additional support and we would support consideration of these proposals.

Section three: Brexit, recruitment and retention

Britain's pubs and brewers are committed to delivering a great customer experience, rewarding careers and fantastic development opportunities. The sector has a unique role in enhancing Britain's reputation overseas and is well placed to be a driving force for growth as the UK prepares to leave the European Union. For British businesses to thrive in a post-Brexit world we should strive to operate the most competitive tax and regulatory regime in Europe. From a resurgence in British beer exports, to major job creation in pubs and the provision of great hospitality for millions of tourists each year, delivering a highly competitive tax and regulatory environment for beer and pubs will reap major rewards for UK plc.

It is vital for brewers and pubs that there remains access to the skills and labour the sector needs to grow and that we retain a business environment that provides for a productive and motivated workforce.

What do we want to see?

It is important that there are no changes to the rights of existing overseas workers in the industry and within the supply chain and any future immigration system must be able to support the necessary levels of staffing for UK businesses. Any quota system that is put into place must take full account of the hospitality sector and areas of staff shortages (such as pub chefs). Finally, we would want to see a commitment to maintaining strong working practices with no erosion of current employment rights.

BBPA has responded to the Government Immigration Bill. We believe that the £30,000 threshold for Tier 2 migrants is too high, particularly for pub chefs. Tier 3 has never been used, but at a time of almost full employment, there is a real need for the 'soft skills', rather than poorly named unskilled workers in our sector. The current terms of the Youth Mobility Scheme need to be enhanced and included in an agreement with all countries in the EU. This allows those under the age of 30 to work in the UK for up to two years (this should be more) and not count against migration numbers.

Moreover, it is vital for British brewers that trading relationships are free and open, so that our sector can continue to flourish and create jobs and growth, and the rest of the world can experience the pleasure of a great British beer. This includes continued access to the EU's electronic movement system, Excise Movement & Control System, which helps reduce costly additional paperwork and non-tariff barriers. A free and open trading relationship with a market as large as the EU must be a priority, with no tariffs or additional paperwork for beer exports.

Tourism and brewing and pubs are closely intertwined. Pubs are third on the list of things to do for overseas visitors to the UK; over half visit a pub whilst they are here. Ensuring Britain's tourism offer remains competitive, with Government support for a sector deal, would therefore be good news for pubs and the wider hospitality sector. The BBPA is a strong supporter of the proposed Sector Deal for Tourism and one of the leading organisations of the skills element of these proposals.

Section four: The Pubs Code

The Pubs Code came into force on the 21st July 2016 and applies to all businesses owning 500 or more leased and tenanted pubs in England and Wales – currently this is Admiral Taverns, Ei Group, Greene King, Marston's, Punch Taverns, and Star Pubs & Bars.

The principle of the Pubs Code is to oversee a fair and lawful relationship between tenants and pub owning companies. This is a principle the BBPA and its members supported throughout the drafting of the legislation and we continue to support that today. In the formation of the Code, Parliament and Government were clear that the leased and tenanted model had a vital role to play in the UK pub market. It is a market that supports a variety of ownership models, broadly encompassing the following:

Tenanted & Leased

Around one-third of Britain's 50,000 pubs operate under this model whereby a brewer or pub company own the pub and rent the premises to a licensee via a lease or tenancy agreement. Most tenancies/leases include a supply agreement for the purchase of beer and a range of other goods and services. Licensees benefit from lower entry costs and pay less than the market rent in return for paying more for their beer. Companies also provide a range of other support measures under this model such as special deals on Sky TV subscriptions, business development support and assistance with marketing. Large pub operators (who own more than 500 leases or tenancies) are now regulated under a statutory code and pubs code adjudicator in England & Wales. Smaller companies operate a voluntary code overseen by the Pub Governing Body, with independent dispute resolution through the Pub Independent Rent Review Scheme (PIRRS) and Pubs Independent Conciliation and Arbitration Service (PICAS).

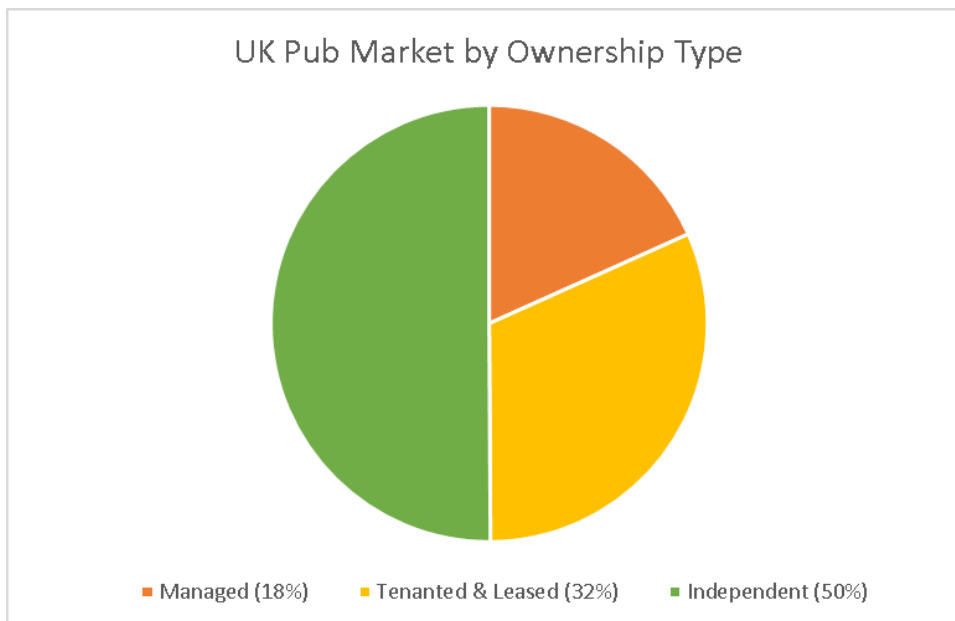
The bulk of pubs owned by BBPA members are either managed, tenanted or leased. More than £200 million is invested by pub operators operating the leased and tenanted model into their pubs every year. This investment enables pubs to ensure that consumers have a great pub experience and makes individual pubs competitive in the eating and drinking out market. In a single year, investment of this kind supports the purchase of hundreds of new kitchens, external decorations and new beer cellars, among many other things.

Managed

The licensee manages the pub on behalf of a pub operator. They are paid a salary and are an employee of the pub operator. There are variations on this model, for example those where the operator is self-employed and receives a percentage of revenue generated by the pub.

Independent

The pub is bought and run solely by the licensee. They will be solely responsible for repairs, maintenance and capital investment in their pub, and are typically able to freely choose their beer supplier.



What has changed since the Code came into force?

As would be expected when such a major piece of regulation comes into force, changes have taken place within the tenanted and leased pub market. We have gathered evidence from the six companies subject to the Code, which suggests that:

- Both the average length of tenure and the number of enquiries regarding new tenancies have increased.
- New tenancy options are being introduced into the market, giving prospective tenants a wider range of choice on how they operate to suit their financial position and operating experience.
- The increased transparency in the market as a result of the Code has meant that recruitment of licensees is more tightly controlled and more efficient. For example, tenants cannot be recruited without an adequate business plan.
- The number of younger applicants taking on a lease has increased since the introduction of the Code.
- Internal procedures within pub owning companies have been refined (and continue to be refined) which have resulted in better services for licensees and better recruitment processes.
- The advent of the Market Rent Only (MRO – explained below) model has seen licensees gain a broader understanding of the risks and rewards of relative pub models, e.g. the lower risk partnership model versus the higher risk and upfront cost of the MRO agreement, which is very similar to a lease to run a shop.

In March 2018, the Pubs Code Adjudicator carried out an extensive survey of pub tenants which found that:

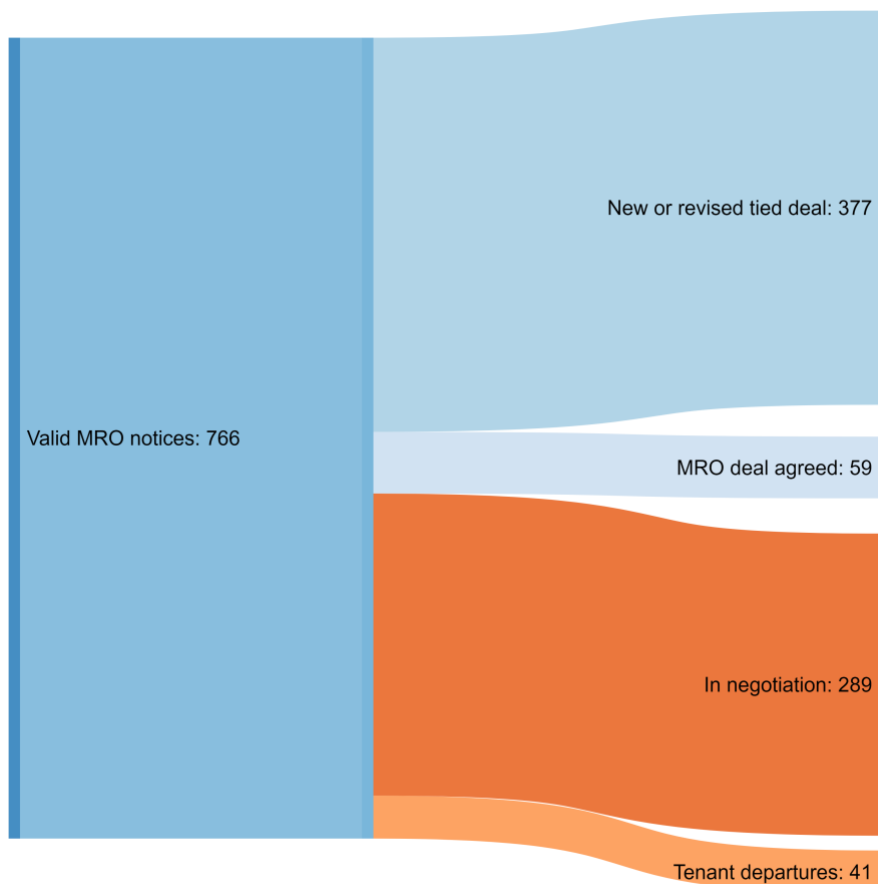
- 72% of tenants are aware of the Pubs Code.
- 63% of tenants were aware of the right to request Market Rent Only agreement at certain trigger points.
- 69% of tenants said they felt they had all of the information required about their pub owning company Business Development Manager.
- 64% of newer pub tenants surveyed stated that they would definitely want to remain as a tenant for at least five years.

The PCA has issued a similar survey for 2019 and we await the results. This remains an iterative process, thanks in part due to the lack of a transitional period and no time for bedding-in of the system, but it is one that we will continue to work on constructively with all stakeholders. The industry will continue to adapt and change to fit the new landscape and we will be responding to the Government’s review of the operation of the Code.

The Market Rent Only option

The Code also brought into force the Market Rent Only (MRO) option for tenants. In short, this element of the Code enables tenants to change their existing supply deal with their pub owning company to one where they can buy beer and other drinks from a third party. This option is available at certain trigger points during the lease and would result in the tenant moving to a deal in which they are paying a market rent for the pub, but receiving none of the benefits associated with the support offered under a pub company lease or tenancy. It is important to note though that the success or failure of the Code should not be judged solely on how many MRO deals come into being as a result of it as this is only one element of the Code, not least because taking on a commercial lease may not suit the financial resources or operational expertise of the tenant or lessee.

The job of the Pubs Code Adjudicator is to oversee the relationship between pub owning companies and tenants should any problems arise, including concerns that may emerge when MRO notices are submitted by tenants. Since the Code came into operation, 766 valid MRO notices have been submitted to pub owning companies; the chart below sets out the outcomes of these notices.



As can be seen, the majority of those cases resolved so far have resulted in a new or revised lease or tenancy deal with a supply agreement between the tenant and pub owning company. Since the Code came into operation, there were an estimated 2,439 trigger points where a tenant could have triggered an MRO negotiation, but less than a third chose to do so and around half of those that used the opportunity to negotiate a revised deal. This would appear to confirm the strengths and continuing popularity of the leased and tenanted model amongst tenants. Furthermore, despite the very short time to prepare for the Code and put systems in place, and notwithstanding some inevitable teething issues, there have been very few disputes referred for arbitration by the adjudicator, other than those about MRO applications. Of the total number of 312 valid cases referred to the PCA for arbitration between July 2016 and March 2019, only 36 have been on non-MRO related disputes. This suggests that the Code itself is working and companies are absolutely committed to operating within the spirit of it.

The data collected from the six companies covered by the Code since July 2016 also shows a higher level of MRO valid notices submitted to them in 2016 (275), than in subsequent years (245 notices in 2017, 219 notices in 2018) suggesting, as expected, a higher rate of application in year one, which then reduces in subsequent years.

Some issues of concern remain around the operation of the Code, particularly around clarity and transparency of guidance, advice and adjudications from the Adjudicator. It is in the interests of all parties to the Code that the PCA begins to make adjudications more quickly than has been the case in the initial period of operation for the Code.

The Code came into effect immediately, despite other sector codes, such as the Groceries Code, being afforded a significant implementation period to work with those effected to identify potential problems and unintended consequences (one year). The six pub owning companies and BBPA share the frustrations of other stakeholders around the length of time taken for arbitrations to take place. It is our view however, that the Code is delivering better negotiating power for tenants, who are using it to negotiate better new or existing agreements with the pub owning companies. The BBPA and companies subject to the Code are keen to see the Code foster greater levels of collaborative working between tenants and pub owning companies and relationships which serve both parties well.

Ahead of the Statutory Review of the operation of the Code, the companies covered by the Code commissioned the economics consultancy Europe Economics to undertake an independent and comprehensive analysis of the performance of the Pubs Code and Adjudicator to date.

The report poses a number of key evaluation questions, assesses the current evidence in seeking answers to these, makes a number of recommendations and identifies where further analysis is required. In short, the report found that although there was good awareness of the Code, there was a need for greater clarity across key areas of the Code for both tenants and pub companies. Although it is difficult to quantify the full impact of the Code at such an early stage, Europe Economics conclude that some of the unintended consequences of the Code could result in a substantial and detrimental impact on the long-term viability of the leased and tenanted model. This in turn has consequences for the wider pub market. A full summary of the Europe Economics report is available on request.

What do we want to see?

We hope that the Government will consider carefully the analysis and findings within the Europe Economics report as part of the upcoming review process. Alongside this we would like to see a continued commitment to an effective and efficient Pubs Code and Adjudicator that ensures fair and lawful dealing for tenants but

also recognises the benefits of the leased and tenanted pub model itself and does not undermine its viability. Finally, we think the Government should consider giving greater direction to the PCA to ensure greater clarity and understanding on key code issues, rather than making any major changes to the Code itself at this still early stage.

Summary

The Great British pub is a valuable institution that is being placed in grave danger due to overly burdensome tax pressures. It is important that the Government recognises the unique place the pub occupies in British society by creating an environment in which they can thrive. The measures discussed in this submission will go a long way to facilitating this. A long-term solution however, that reduces significantly the disproportionate rates burden for the nations pubs remains vital.