Claire Higgins, head of research at BNP Paribas Real Estate, the leading property adviser, shares her thoughts on potential property implications to a change to the RPI:

"On 18th September, the Office for National Statistics announced that it will consult on changes to the Retail Prices Index (RPI) formula.

There has been much discussion in the media on the potential impact on pensions and bonds, but as yet no comment on the relationship between RPI and property.

Many UK commercial properties are let on RPI-linked leases, but key sectors favouring this lease structure include supermarkets, department stores, hotels, pubs, cinemas and other leisure uses, student accommodation and schemes let to the public sector.

CPI has been lower than RPI for most of its history and one of the main drivers of this is a “formula effect” — the difference between the methods used to calculate the two measures.

There are several proposed options: to make no change, to reduce the formula effect to differing degrees, or to remove it entirely. The potential outcome of this consultation could, therefore, range from 0% (if no alteration is made) to nearly 1% knocked off RPI if the formula effect is fully removed.

The Office for Budget Responsibility previously reported that a 1% drop in RPI inflation would cut the Government’s debt service payments by about £3bn for 2013-14, rising to about £6bn for 2016-17, which would naturally be very appealing to the Chancellor.

Both investors and occupiers should be aware that this consultation is imminent. The consultation will open on 8th October and close on 30th November 2012. Should a change be made, it would be introduced in March 2013.
And make no mistake. The Office for National Statistics wants it changed. As Chris Giles, economics editor of the FT, points out, “Consultations are not launched when experts think the status quo is fine.”

Occupiers or investors who have hedged any inflation-linked liabilities would, of course, not see any difference going forward as any change would be matched on both sides of the balance sheet. Alternatively, the reason that occupiers such as supermarkets often opt for RPI-linked leases is that their income is inflation driven, i.e. their products effectively define the RPI index and thus they have an in-built hedge.

From an investor’s perspective, if an asset has been purchased because its lease structure ensures the income stream is inflation-proofed, then the basis on which that inflation is measured is effectively irrelevant.

For leases with caps and collars on the rate of change, however, a methodological amendment which could reduce RPI by up to 1% could mean that those collars are in the wrong place.

A more directly positive aspect for occupiers would be the impact on business rates. Brandon Lewis, parliamentary under secretary of state for communities and local government, highlighted in a statement on the recent much-criticised postponement of the revaluation to 2017 that: “As business rates are linked to inflation, there will be no real terms increase in rates over this period.” In fact, as rates are linked to RPI rather than CPI, a potential reduction through the methodological change could knock up to 1% off the annual increases.”

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About BNP Paribas Real Estate
BNP Paribas Real Estate, leading international real estate provider, offers to its clients a comprehensive range of services that span the entire real estate lifecycle: property development, transaction, consulting, valuation, property management and investment management.
BNP Paribas Real Estate has local expertise on a global scale through its presence in 36 countries through more than 150 offices and 3,400 employees (16 wholly owned subsidiaries and 20 by its Alliance network, that represents today more than 3,000 people). BNP Paribas Real Estate is a subsidiary of BNP Paribas.
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