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Legal alert

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Sainsbury's, Tesco, Co-op and others v Sykes and other valuation officers [2017] UKUT 0138 (LC)

For the purposes of business rates, all business premises are divided into individual rate-paying units known (on Planet Rating) as hereditaments.

Supermarket operators have long been installing ATMs (i.e. cash machines) at their supermarkets and other stores without distinguishing the ATM site from the host store for rating purposes.

However, in 2014, rating valuation officers amended their rating lists by including the sites of many thousands of supermarket ATMs as separate hereditaments. The effect was to increase the total rates bill for each store. Premises assessed as two hereditaments usually attract higher business rates than if they were assessed as a single hereditament. Indeed, in most cases, the ATM site was given its own rateable value without any corresponding reduction in the rateable value of the host store.

After much legal analysis of centuries of judge-made rating law, the Upper Tribunal decided that the valuation officers were right to rate some of the ATM sites separately but not others.

There are two types of ATM site, said the tribunal. Firstly, there are those that are "internal" i.e. those that face onto the shop floor of the store and are accessible only to those who have entered the store during opening hours. Each such internal ATM site is under the de facto control of the store operator, who is therefore the "rateable occupier". Since the rateable occupier of the internal ATM site and the rateable occupier of the host store are one and the same, there can be no question of there being separate hereditaments (which is why the ATM machines installed in your local bank branch are not separately rated from the branch itself).

Secondly, however, there are those ATM sites that are "external" i.e. those that are built into (and face out of) the external wall of the store and are available 24 hours a day to anyone who happens to be passing by. Internal ATMs are primarily aimed at customers of the store, while external ATMs are aimed at the public at large.

An external ATM site, said the tribunal, is under the de facto control of the relevant bank who owns and operates the ATM machine itself. It is the bank who is therefore the rateable occupier of an external ATM site. Each external ATM site should therefore be separately assessed for rates from the host store.

The result is that some ATM sites face a hike in rates, but not others. It is an outcome that fails to please neither the banks and store operators, nor the valuation officers.

An appeal to the Court of Appeal is likely.

- Timing of hedge: Usually lenders insist that hedging needs to be done within a certain time-frame from the date of approval of the loan. It is important that the hedge is completed when the loan has been disbursed, or, if done prior to the disbursement, there is no uncertainty whatsoever on the amount of loan that will be disbursed and its repayment schedule once disbursed. This will ensure that borrowers do not enter into unwanted hedges in situations when loans are not disbursed, or not required for some reasons such as a property deal falling through, leaving them to substantial risks (of potential losses or gains) on unwinding of hedges.
- Type of hedge: Interest Rate Swap, Cap, and Collar are the main hedging instruments. The choice of hedge instruments should be aligned to the underlying business, and prevailing market conditions. An Interest Rate Swap fixes the interest costs and has the advantage of known costs, however it is not flexible if the loan is to be repaid prematurely. Fixing the interest rate also has the disadvantage of high opportunity cost in the case where interest rates remain low or become even lower. The Cap is an insurance-like instrument and protects the borrowers from interest rates going above a chosen level and lets borrowers take advantage of prevailing lower rates in case rates do not increase. The Cap can also be unwound at no further costs in case the borrower decides to pay the loan prematurely. However, a premium is required to be paid for a Cap hedge. The Collar hedge is a hybrid between an Interest Rate Swap and a Cap hedge and fixes the interest rate costs between chosen boundaries for zero or small up-front cost. No complicated or exotic hedges, such as callable hedges, should be considered and hedging notionals or tenors should not exceed the underlying loan notionals or tenor.
- Optimal hedge execution: This is the single most important area where the appropriate expertise and focus from borrowers can save them substantial costs on hedge margins charged by banks. It is important to benchmark the hedge pricing provided by banks in a live setting by breaking down the price to mid-price, bid-offer spread, and adjustments to reflect credit, regulatory and other charges of banks. Where possible, hedge provider banks should be put in competition with each other. This process can help to substantially reduce the charges by banks to a fair level resulting in considerable savings to the borrower. Depending on the size of hedge and volatility in the underlying markets, selection of hedge execution time is also a relevant consideration to achieve optimal execution.
- Pre and Post Hedge Execution Documentation, Reporting and Monitoring: A borrower has to sign an ISDA Master agreement with hedging banks prior to the hedge execution. The negotiation of an ISDA document can take time and appropriate legal assistance should be sought by the borrower to ensure that the agreement is fair and conforms to market standard. The borrower will also need to get an LEI (Legal Entity Identifier) or a unique temporary or definitive code identifying them for the purposes of their obligations post trade execution under the European Market Infrastructure Regulation (EMIR).

Once the hedge has been executed, a trade confirmation is issued by the bank and signed by both parties. The borrower should ensure that the trade confirmation reflects the terms of actual trade and in case of any discrepancies, the same are resolved immediately.

Post hedging, it is also important for the borrower to monitor the hedge and its valuation periodically to ensure that the hedge still serves their objectives. Any changes in circumstances such as prepayment of loan, refinancing of loan or sale of underlying asset could affect the hedging and may necessitate the restructuring or termination of hedging with cost/gain consequences. Before any hedge unwinding or restructuring is carried out, a full rationale should be established and its execution carried out optimally and cost effectively.

Finally, although banks as hedge providers can provide a lot of information to the borrowers on hedging, they do not advise on the suitability or appropriateness of hedging deals. Hedging is a specialist area, and if required, the borrowers should seek advice from independent Financial Conduct Authority (FCA) authorised hedging advisers to ensure optimal hedge selection, hedge execution and pre/post hedge management. This will also help the borrower avoid any pitfalls faced by a number of both small and large borrowers all over the world, which have resulted in the purchase of inappropriate hedging products by borrowers, mis-selling of swap products, or excessive profit taking by banks on such products.

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