

Background

From March through to August 2020, the UK Government ran a Consultation on the Reform to Retail Prices Index Methodology (the Consultation). The purpose of the Consultation was to consider whether the UK should officially move away from the Retail Price Index (RPI) and towards the Consumer Price Index (including owner occupier housing costs) (CPIH).

Having been introduced as the Government's primary measure of inflation in 1947, RPI underlies the vast majority of index-linked financial contracts in existence today. However, its antiquity means that it is now widely accepted as being unfit for purpose. For example, the Office for National Statistics abandoned RPI in favour of CPIH in 2017 because it was too often producing inaccurate rates of inflation that did not properly reflect rising costs in the UK.

The UK Statistics Authority (UKSA) is the independent statutory body responsible for the production and publication of official statistics, and by law it is required to compile and maintain RPI. Following the Consultation, the UKSA decided that it would bring "*the methods and data of CPIH into RPI*" – effectively replacing RPI's basket of goods with that of CPIH.

This decision has not been welcomed by all. In October 2020, the Chancellor refused to consent to the proposed change on the basis that it would too greatly impact holders of UK Treasury index-linked gilts, the last of which mature in 2030. Following their maturation, however, the Chancellor's consent is no longer required and the change can go ahead unimpeded. This has left institutional investors deeply unhappy – the High Court is hearing a judicial review that has been brought by trustees of some of the UK's largest pension schemes in an attempt to block the change. Although the percentage difference between RPI and CPIH may appear small, the change would result in hundreds of millions of pounds being wiped from the value of defined-benefit pension schemes. There is therefore much at stake.

Notwithstanding the judicial review, it appears the Government is turning its back on RPI. Even if the claim is ultimately successful, it is entirely possible that Parliament would simply respond by amending the legislation to tweak the UKSA's responsibility from "*compiling and maintaining the retail prices index*" to "*compiling and maintaining the consumer prices index*".



How the Change May Impact the UK Property Market

Companies which invest in property in the UK should be prepared for what may come. In particular, the change from RPI to CPIH is likely to impact the property market in respect of rent review provisions from 2030 onwards.

If the High Court allows the UKSA to implement the change "via the back door" by effectively converting RPI to CPIH, then leases that contain index-linked rent review clauses will see a smaller rise in payable rent (presuming continuing inflationary conditions), favouring tenants. If RPI is instead statutorily changed to CPIH, not only will we see a reduced increase in rental prices, but all existing index-linked rent review clauses will also need to be amended to reflect the switch.

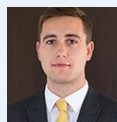
However, in response to the reduced price increase, it is possible that landlords may simply begin to demand a CPIH-based formula that aims to replicate RPI, for example CPIH + X number of basis points, known as "CPIH Plus", tipping the scales back in their favour. This leaves us with a situation where RPI is, in effect, still used – it is akin to abolishing the colour green and replacing it with "the aggregate of blue and yellow". If this approach is adopted, it is difficult to see how *true* CPIH can be accepted across the sector. Tenants should, therefore, be encouraged to question proposed rent review clauses that artificially seek to inflate rental values in this way.

Stamp Duty Land Tax (SDLT) calculations will also be affected as RPI adjustments in rent review clauses are disregarded for the purposes of calculating SDLT. A change to CPIH would mean that the rent review provisions cannot be disregarded and the effect of the rent review would need to be accounted for in the SDLT return.

How We Can Help

Our Real Estate team regularly advises a number of clients who wish to enter into new and existing leases, as well as advising on the resulting SDLT implications. We will continue to be on hand to guide clients through the proposed transition. Look out for further updates when the High Court makes a decision on the judicial review claim, but, in the meantime, please contact us if you would like more information on how we can help you prepare for the future.

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